

**CHANGING ROLES IN A CHANGING CLIMATE:
THE BRETTON WOODS INSTITUTIONS AND THE PROMOTION OF
SUSTAINABLE DEVELOPMENT**

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ABSTRACT

Through structural adjustment programmes (SAPs), the Bretton Woods Institutions (BWIs) have been promoting a particular model of development in developing countries. However, the traditional model of “economic” development advocated by the BWIs has been criticised for contributing to environmental degradation generally and to increases in greenhouse gas emissions linked to climate change. A variety of legal instruments and other mechanisms have been developed that seek to reverse this trend. The Framework Convention on Climate Change (FCCC) was adopted in 1992 and innovative mechanisms designed to help implementing the Convention such as the Global Environment Facility (GEF) have been established in the World Bank.

The purpose of the thesis is to evaluate whether the legal and quasi-legal instruments employed by the BWIs in promoting structural adjustment may serve as effective tools in assisting to implement the FCCC in developing countries.

The effectiveness of these legal and quasi-legal instruments, including conditionality and policy-based lending, is examined in the context of the leverage of the BWIs in influencing developing countries. This thesis posits that the governance structure of the BWIs, perceived as asymmetrical by developing countries, has affected the relationship between the BWIs and developing countries and might have undermined the effectiveness of these instruments in promoting structural adjustment. This thesis shows that GEF has begun to employ instruments similar to SAPs such as conditionality and policy-based lending, but in combination with innovative features such as novel decision-making rules and closer links with multilaterally negotiated environmental agreements such as the FCCC. The present study, thus, proposes that these legal and quasi-legal instruments identified in the GEF might be more effective because of the innovative features of the GEF that help to improve the relationship between the World Bank and the developing countries.

The interaction between treaty obligations of the FCCC and regular operations of the BWIs is further explored, and suggestions for reforming the SAPs and in further developing the innovative mechanisms of the World Bank are offered. The arguments presented in the thesis are illustrated through a case study comprising four developing countries of Southeast Asia (Malaysia, Indonesia, Philippine, and Thailand). By evaluating whether the experiences of the BWIs in promoting “economic” development can provide valuable insights into how they might promote “sustainable” development through assisting the implementation of the FCCC in developing countries, the thesis hopes to contribute to the evolving field of study on the interface between international financial institutions and international environmental law.

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ABBREVIATIONS

ADB	Asian Development Bank
AIJ	activities implemented jointly
ASEAN	Association of South East Asian Nations
BOP	balance of payments
BP	Bank Procedures (of the World Bank)
BWI	Bretton Woods institutions
CBD	Convention on Biological Diversity
CCFF	Compensatory and Contingency Financing Facility (of the IMF)
CDM	Clean Development Mechanism (of the Kyoto Protocol)
CIF	Carbon Investment Fund (of the World Bank)
CO₂	carbon dioxide
COP	Conference of the Parties
CSD	Commission on Sustainable Development
ECOSOC	Economic and Social Council (of the United Nations)
EFF	Extended Fund Facility (of the IMF)
EIT	economies in transition
ESAF	Enhanced Structural Adjustment Facility (of the IMF)
EU	European Union
FCCC	Framework Convention on Climate Change
FDI	foreign direct investment
FY	fiscal year
G-24	Inter-governmental Group of 24 on International Monetary Affairs.
G-77	Group of 77 developing countries
GATT	General Agreement on Tariffs and Trade
GCI	Global Carbon Initiative
GDP	gross domestic product
GNP	Gross National Product
GEF	Global Environment Facility
GEF P	pilot phase Global Environment Facility
GEF I	restructured Global Environment Facility
GET	Global Environment Trust Fund
GHG	greenhouse gas
GNP	gross national product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Agency

IEA	International Energy Agency
IFC	International Finance Corporation
IMF	International Monetary Fund
INC	Inter-governmental Negotiating Committee for a FCCC
IPCC	Inter-governmental Panel on Climate Change
JI	joint implementation
MEA	Multilateral environmental agreement
MIGA	Multilateral Investment Guarantee Agency
MOP	meeting of the parties
MOU	memorandum of understanding
NGO	non-governmental organisation
NIC	newly industrialised country
NIEO	new international economic order
OD	Operational Directives (of the World Bank)
OMS	Operational Manual Statements (of the World Bank)
OP	Operational Policies (of the World Bank)
OTF	Ozone Trust Fund
PCF	Prototype Carbon Fund (of the World Bank)
PFP	Policy Framework Paper
SAF	Structural Adjustment Facility (of the IMF)
SAL	Structural Adjustment Loan (of the World Bank)
SAP	Structural Adjustment Programme
SBI	Subsidiary Body for Implementation (of the FCCC)
SD	sustainable development
SDR	special drawing right
SECAL	Sectoral Adjustment Loan (of the World Bank)
STAP	Scientific and Technical Advisory Panel (of the GEF)
UNCTAD	United Nations Conference on Trade and Development
UNCED	United Nations Conference on Environment and Development
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UN	United Nations
WCED	World Commission on Environment and Development
WMO	World Meteorological Organisation
WTO	World Trade Organisation

CHAPTER 1: INTRODUCTION

The purpose of this thesis is to evaluate whether the experiences of the Bretton Woods Institutions (BWIs) in promoting “economic” development, a traditional development model, can provide valuable insights into how they might instead promote “sustainable” development through assisting the implementation of the 1992 Framework Convention on Climate Change (FCCC) in developing countries. Issues relating to this evaluation and raised in the present studies are categorised into two groups. The first relates to the governance structure of the BWIs and the second concerns the interaction of the BWIs with multilateral environmental agreements (MEAs) in particular the FCCC.

First, this thesis will investigate developing countries’ perception of the BWIs governance structure, and how this perception affects the relationship between the BWIs and developing countries and possibly undermines the effectiveness of the legal and quasi-legal instruments employed by the BWIs to influence developing countries. Secondly, this thesis will examine the impact the FCCC have on the regular operations of the BWIs and how this increasing interaction has led to the involvement of the World Bank in innovative mechanisms such as the Global Environment Facility (GEF).

1.1 Purpose of this thesis

1.1.1 Background

The International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) — the so-called BWIs — have been at the forefront of international efforts to promote economic stability and development in their member states since their establishment in 1944. When most of the developed country

members ceased to borrow from the BWIs after the 1970s¹, the BWIs began to focus on structural economic problems and the promotion of development in their developing country members. The prevailing development model favoured by the IMF and World Bank management² focused on “economic growth” (Griesgraber and Gunter, 1996a). As a result, the mode of “development” promoted by the BWIs in the developing countries mainly aimed at maximising economic growth, usually measured by the growth of Gross National Product (GNP) per capita and by the level of industrialisation³.

This model of development, promoted by the BWIs, not only brought about economic transformation in the developed countries, but also contributed to changes in their natural environment. Disillusionment with this traditional development model and its failure to take into account the environmental constraints of the ecosystem contributed to a rise of environmentalism in those countries. Various schools of thought have attempted to challenge the theoretical underpinnings of this traditional model of development, and have offered alternative theories⁴. The most prominent alternative proposed to this traditional model of development, which has gained the widest international support, is the concept of sustainable development. Starting with the 1972 Stockholm Declaration, various international instruments and declarations have reiterated the relationship between development and environment. The 1987 Brundtland Report⁵, a non-binding but influential set of recommendations from a high-level group of

¹ For example, the last borrowing — “drawing” as termed by the IMF — from the IMF by the major industrialised countries (known within the IMF as the “G-10”) was made by the UK in 1977. There has been no drawing by the G-10 since then (Graham, 1995).

² The “management” of the BWIs referred to in the present study includes their respective Boards of Executive Directors and staff.

³ See, for example, the World Economic Outlook published annually by the IMF.

⁴ For example, some advocate a “zero growth” or the steady state economy strategies to respond to this growth intensive development path (Daly and Townsend, 1994, part III).

⁵ For the historical account of the concept “sustainable development” before the 1992 Rio Conference, see Adams, 1990, chapters 2 and 3.

policymakers⁶, gave birth to the most widely referred to definition of sustainable development⁷. The 1992 Rio Declaration introduced principles to the field of international law relating to sustainable development⁸. Agenda 21, another document produced at the 1992 UN Conference on Environment and Development (UNCED), provided, *inter alia*, action programmes for reforming international financial institutions (chapter 38). One commentator concludes that “what is urgently needed is a change in the nature of economic development in order to deal with the ever-widening scope of environmental degradation” (Williams, 1995, p. 196).

However, one might doubt whether a shift of development paradigm from “economic” development to “sustainable” development has truly occurred, and whether the practice within the BWIs has changed accordingly. Both of the BWIs, through various public statements by their high level management⁹, have officially committed themselves to the goal of sustainable development. In practice, however, their operations are still being criticised as ignoring the social and environmental impact of their projects and programmes (eg Cornia et al, 1987; Reed, 1992 and 1994; Rich, 1994). The BWIs have responded to these criticisms by adopting new practices such as the “social safety net” and new internal policies on, for example, environmental impact assessment. As the World Bank itself concluded in 1997: “In the past five years [after Rio] the [Bank] has

⁶ The World Commission on Environment and Development, the body that produced the Brundtland Report, was set up as an independent body by the UN in 1983. It was chaired by the Norwegian Prime Minister Gro Harlem Brundtland and consisted of several cabinet ministers and senior economists in the national governments.

⁷ The Brundtland Report defines sustainable development as “development that meets the need of the present without compromising the ability of future generations to meet their own needs” (World Commission on Environment and Development, 1987, p. 43).

⁸ Literature abounds with regard to the legal implications of the concept sustainable development under international law, see, for example, Freesone, 1994; Lang, 1995; and Sands, 1994.

⁹ For example, the President of the Bank and the Managing Director of the IMF both recognised the importance of this concept at the 1992 UNCED. Also, more recently, the speech by the President of the

become the major financier of programs addressing the objectives laid out in Agenda 21.” (World Bank, 1997a, p. 3) Nevertheless, the Bank still has large lending operations to fund fossil fuel-related projects in developing countries¹⁰. These, in turn, lead to greenhouse gases (GHGs) emission and contribute to the problem of climate change. The “climate friendliness” of the Bank’s portfolio has emerged as a test of the efforts made by the BWIs to promote “sustainable development”.

As the potential threat of climate change became known and attempts to deal with it escalated to the international scale, an international legal instrument was opened for signature at the UNCED, the 1992 UN FCCC, which has incorporated several principles pertinent to the goal of sustainable development¹¹ and is referred to by one commentator as “... a Convention about sustainable development rather than environmental protection” (Sands, 1994, p. 331). The causes of and solutions to climate change lie in every aspect of human economic activities, with “development” being an important aspect. This has brought increasing interaction between the FCCC and the BWIs, as BWIs are often the main international institutions that promote “development” in their member states. The best example is the energy sector. A country’s energy policy is an integral part of its development strategies and has been a focus of the BWIs since the

Bank at the UN Assembly Special Session on the environment in 1997 also reiterated the Bank’s commitment to the goal of sustainable development.

¹⁰ Lending for energy typically represents between one-fifth and one-sixth of the total annual commitments of the IBRD and IDA. In FY 1997, IBRD and IDA lending for oil, gas and coal represents 43% of the total commitments in the energy sector (World Bank, 1997d).

¹¹ Principles in the field of sustainable development and their legal implications have been subject to extensive discussion since the term emerged in 1987. See, for example, Sands, 1994; CSD, 1996. Nevertheless, various principles adopted in the FCCC Article 3 such as precautionary principle and common but differentiated responsibilities have been widely perceived as closely associated with the spirit of sustainable development.

early days of their operations¹². Energy policy can also affect a country's GHGs emissions by, for example, determining the relative reliance on fossil fuel and renewable energy sources. In addition to energy policy, policies implemented to maximise economic growth and encourage industrialisation, two landmarks for the traditional model of development promoted by the BWIs, are linked to increases in GHGs emissions. Assisting with the implementation of the FCCC can enable the BWIs to put into practice their public endorsement of the goal of "sustainable development". The purpose of the present study is to evaluate whether the BWIs can effectively employ the legal and quasi-legal instruments that have been used in the past to promote "economic" development to play this new role in assisting the implementation of the FCCC in developing countries.

1.1.2 Governance structure of the BWIs

The BWIs have been flexible in institutional and operational reforms in responding to the changing external socio-economic environment in which they operate and internal demands from member states with different needs. However, one feature that remains constant and controversial is the governance structure¹³ of the BWIs. The decision-making rules based on weighted voting system have given the developed countries a dominant power in making decisions relating to the operations of the BWIs.

¹² The importance of energy policy was re-affirmed after two oil crisis of the 1970s. For example, an oil facility was set up in the IMF in 1975 and energy conservation policy has been incorporated as a part of conditionality if access to this facility is to be granted. See Chapter 3.4 for further discussion.

¹³ Governance structure encompasses institutional aspect such as the hierarchy of different bodies within an organisation with different function, as well as substantive aspect such as voting rules prescribed for the operations of these bodies. The term "governance structure" is, nevertheless, used loosely in the present study. In the context of the BWIs, "governance structure" refers to the decision-making rules, the weighted voting system, within the Boards of Executive Directors. In the context of GEF, governance structure refers to not only the decision-making rules within the GEF Council, but also various arrangements agreed with the FCCC in setting up formal link with the Convention.

Developing countries have been campaigning for the reform of this governance structure since the 1970s. This thesis examines how the BWIs' governance structure led to the perception of asymmetry in the operations of the BWIs from the developing countries' viewpoint. This perception has strained the relationship between the BWIs and the developing countries and, as this thesis shows, might have undermined the effectiveness of the legal and quasi-legal instruments employed by the BWIs to influence developing countries.

1.1.2.1 Structural adjustment programmes

As mentioned earlier, BWIs have been at the forefront of international efforts to promote development. They have employed various legal and quasi-legal instruments in the past to promote the particular model of development in developing country clients. Before the threat of climate change was widely perceived, the BWIs, drawing upon the experiences and ideologies of their developed country members, regarded economic growth and industrialisation as the optimal goal of "development", and designed their programmes and operations accordingly for their developing country members. Structural adjustment programmes (SAPs), associated with structural adjustment lending¹⁴, have been the primary mechanism employed by the BWIs to influence developing countries to pursue this model of development.

Based on the existing empirical research conducted by the BWIs and external institutions, this thesis intends to analyse the effectiveness of the SAPs at two levels. Firstly, whether SAPs have been effective in producing changes of domestic law and

¹⁴ Structural adjustment lending mainly refers to the following lending mechanisms of the BWIs: the Structural Adjustment Facility and the Enhanced Structural Adjustment Facility of the IMF, and Structural

policy in the borrowing developing countries, ie their effectiveness in producing an *outcome*. Secondly, whether, as a result of these changes of laws and policies, SAPs have been effective in producing the intended results¹⁵ in the borrowing country, ie their effectiveness in producing an *impact*¹⁶.

This thesis intends to demonstrate that, with the application of conditionality and programme and policy-based lending — arguably the most powerful tools employed to influence developing countries — the SAPs have, to a certain extent, been able to induce changes of domestic laws and policies in the borrowing government. Namely, the somewhat coercive SAPs have been effective at producing an *outcome*. On the other hand, from the existing literature, the effectiveness of the SAPs in producing the intended result has been subject to keen debate and no consensus can be achieved as to whether the overall economic situation in the borrowing countries have improved as envisaged by the SAPs. In other words, the BWIs and their SAPs might be less effective at producing

Adjustment Loan and Sectoral Adjustment Loan of the IBRD. For further discussion on the concept of structural adjustment, structural adjustment lending of the BWIs, and the SAPs, see Chapter 3.1 and 3.2.

¹⁵ To put it more precisely, whether the SAP has achieved the intended “economic” impact as envisaged by the BWIs in the borrowing country by improving the economic state of the country. The SAP has been criticised for producing other impact such as social inequality and environmental degradation, as can be attested by the amount of literature produced by NGOs and academic institutions (eg Cornia et al, 1987; Reed, D, 1992 and 1994). Nevertheless, the main purpose of the SAP is to correct the structural problems in a country’s economy and its intended goal is to improve the country’s balance of payments situation and other macroeconomic policies. Although the impact of the SAP goes beyond the intention of the architect of the SAP, it is precarious to imply that the allegedly negative impact on the poor and on the environment is intended when the SAP is designed. Thus, the thesis will only focus on the “economic”, as opposed to other unintended impact of the SAPs when examining the effectiveness of the SAP in producing an *impact*. Note that limited discussion on the environmental impact of the SAP, in particular on climate change, will take place in Chapter 5 for its relevance in the recommendations proposed in the chapter.

¹⁶ The terms “outcome” and “impact” are borrowed from the analysis of regime effectiveness, in particular international environmental regime, in the international relations school. A regime can be evaluated on the basis of the norms, principles and rules constituting its substantive contents (*output*), or on the basis of the consequences flowing from the implementation of and adaptation to these norms and rules. When dealing with environmental regimes, the latter may be further specified by making a distinction between influence on human behaviour (*outcome*) and consequences for the state of the biophysical environment itself (*impact*) (Underdal et al, October 1998). Nevertheless, the detail discussion and analytical tools used in the international regimes study will not be employed in this thesis. For further discussion, see, for example, Bernauer, 1995; and Levy et al, 1995.

an *impact* in the developing countries. By investigating the governance structure of the BWIs and the implications it bears on the relationship with their developing country members, this thesis proposes that, one of the reasons for the lack of effectiveness at producing an *impact* might be embedded in the governance structure of the BWIs. As pointed out earlier, the governance structure and the operations of the BWIs have been perceived as asymmetrical by developing countries and this perception has affected the relationship between those two parties. This strained relationship, as this thesis argues, might have undermined the borrowing governments' determination to carry out SAPs and, as a result, affected the effectiveness of the SAPs¹⁷. This issue of governance structure and how it might affect the effectiveness of the BWIs programmes can, as we shall see later, have profound implications for the World Bank in the process of assisting the implementation of the FCCC through its various innovative mechanisms.

1.1.2.2 Innovative mechanisms of the World Bank

As private capital became increasingly available to the wealthier developing countries, such as those in East and South-east Asia, the World Bank has been searching for another role other than providing financial resources for traditional "economic" development. Private capital has, however, been reluctant to provide the huge resources needed for implementing the alternative development models promoted by the FCCC¹⁸. Furthermore, interaction between the BWIs and the FCCC has been increasing as their membership and areas of competence began to overlap. In search of a new role, the

¹⁷ This situation has been referred to as the "borrower or programme ownership" problem (eg Killick, 1995a; Johnson and Wasty, 1933) and will be subject to closer examination in Chapter 3.5.2.

¹⁸ This lukewarm attitude from the private sector might begin to change as market-based instruments such as emission trading are authorised by the Kyoto Protocol as implementation mechanisms. For example, the

World Bank has developed, or is in the process of developing, various innovative mechanisms for the purpose of assisting the implementation of the FCCC in its developing country clients. These innovative mechanisms that are examined in the present study include GEF¹⁹, the World Bank's Activities Implemented Jointly (AIJ) programme developed in collaboration with the government of Norway²⁰ and the proposed Global Carbon Initiative (GCI) and its Prototype Carbon Fund (PCF)²¹.

The GEF has had the most operational experience out of the three innovative mechanisms. As this thesis illustrates, GEF operations have been gradually developing legal and quasi-legal instruments similar to those employed in the SAPs by the BWIs. These instruments include the application of conditionality and programmatic and policy-based lending, possibly the two most powerful tools used by SAPs to produce an *outcome* from the borrowing governments. As a result, GEF has the potential to induce the policy changes in the recipient countries that support GEF objectives. On the other hand, this thesis identifies two distinctive characteristics of GEF that have implications for the asymmetry problems perceived by developing countries to be associated with the BWIs, which might be one element that undermined the effectiveness of the SAPs in producing an *impact*. The first is its novel decision-making rules²², under which power is more evenly distributed between developed and developing countries. Also the latter

private sector is to play a major role in one of the Bank's innovative mechanisms: the Prototype Carbon Fund.

¹⁹ GEF is a pool of fund from the contributions of mostly developed countries and provides funding to eligible developing countries to finance the incremental costs for projects with global environmental interests. For a more detailed discussion on GEF, see Chapter 4.1.2.1.

²⁰ A pilot phase for AIJ was established by the Parties to the FCCC as one of the possible mechanism for joint implementation. The World Bank initiated a three-year programme on AIJ in collaboration with the government of Norway in April 1996. For more detail discussion, see Chapter 4.1.2.2.

²¹ This is still under development within the World Bank. The idea is to launch a "Prototype Carbon Fund" as a market intermediary by obtaining funds from investors and investing in projects which would result in carbon emission reductions. For more detail discussion, see Chapter 4.1.2.2.

²² See Chapter 4.2 for further discussion on the governance structure of GEF.

may participate in the decision-making process on a more equal footing. The second feature is the closer link between GEF and the FCCC. Under the arrangement between the two, developing countries may be more confident that their priorities will be incorporated in the operations of GEF via the forum of the Conferences of the Parties (COPs) to the FCCC. As a result, in spite of its association with the World Bank and its similar features to SAPs, GEF might be perceived by developing countries as less asymmetrical than the existing mechanisms of the BWIs. This thesis, thus, argues that as GEF becomes less asymmetrical, developing countries might be more willing to co-operate and carry out conditionality and policy advice attached to GEF grants and produce the intended impact that GEF hoped to achieve²³. In other words, the legal and quasi-legal instruments employed by the BWIs might achieve greater effectiveness in this new role of assisting the implementation of the FCCC assumed by the World Bank.

On the basis of the aforementioned arguments, this thesis suggests that one of the keys for the BWIs programmes to achieve effectiveness in producing *outcome* as well as *impact* lies in the governance structure and how it affects the relationship between the BWIs and the developing countries. If this relationship could be improved as a result of the novel governance structure of the innovative mechanisms, the BWIs, and in particular the World Bank, may be able to apply their financial resources, and legal and political influence more effectively to assist in the implementation of the FCCC in their developing country members. The manner in which the BWIs can use this influence and

²³ One limitation in the validity of this argument is that empirical evidence of the “asymmetric GEF operations” and their effectiveness is difficult to come by at the moment, for conditionality and policy advice are not yet fully developed in GEF lending and grants, see Chapter 4.3 for further discussion.

their legal and quasi-legal instruments to play this new role in their developing country members is the second theme of this thesis.

1.1.3 Interaction between the BWIs and the FCCC

Concern with environmental reform in general within the World Bank dates back to the 1980s as a response to external criticism coming mostly from environmental non-governmental organisations (NGOs) and, later, the US Congress²⁴. The BWIs, bound by their respective Articles of Agreements, must base their decisions on economic, non-political, grounds²⁵. The BWIs have, in the past, justified their failure to consider, for example, human rights issues, or human rights impact of their operations in borrowing countries by arguing that their mandate only allows them to take into “economic” considerations in their operations and specifically excludes such “political” concerns (eg Shihata, January 1992). Nevertheless, the meaning and content of “economic” consideration have been subject to interpretation and re-interpretation by the two institutions to discuss issues such as education and “good governance” (Bradlow and Grossman, 1995). Furthermore, the basic underpinning of the concept “sustainable development” lies in the integration of economic and environmental policies (eg Muschett, 1997). In the case of climate change, the causes and solutions particularly require the integration of several environmental considerations into economic decision

²⁴ For a more detailed account on how the NGOs and the USA Congress have influenced the World Bank’s environmental practices, see Bowles and Kormos, 1995; Le Prestre, 1989, chapter 3; and, Mikesell and Williams, 1992, chapter 9; Rich, 1994.

²⁵ Article I of the IMF Articles of Agreement states that: “The Fund shall be guided in all its policies and decisions by the purposes set forth in this article.” According to Gold, this provision forbids the Fund from taking political considerations into account (Gold, May 1983). Article III, Section 5(b) of the IBRD’s Articles of Agreement states that: “The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and *without regard to political or other non-economic influences or considerations.*” (emphasis added)

making. As a result, the World Bank's efforts to assist the implementation of the FCCC and achieve sustainable development objectives have not been viewed as derogating from the obligation imposed by its Articles of Agreement to take into account only "economic" consideration in its operations.

Furthermore, the areas of competence and membership have already begun to overlap between the BWIs and the FCCC. For example, it is provided in the FCCC that its Parties are to "co-operate to promote a supportive and open international economic system that would lead to sustainable economic growth and development in all Parties" (FCCC, Article 3.5) and that all parties shall "take climate change considerations into account ... in their relevant social, economic and environmental policies and actions" (FCCC, Article 4.1[f]). All these obligations touch upon the economic and developmental policies of the Parties, over which the BWIs traditionally have competence. This increasing interaction has its ramifications for the BWIs. This thesis illustrates that the existence of the climate change regime²⁶ affects the regular operations of the BWIs through the different treaty obligations imposed by the FCCC on developed and developing countries that are either decisionmakers or recipients of the BWIs. Thus, this thesis argues that the staff and management of the BWIs can no longer carrying out their regular operations without properly taking into account obligations under the climate change regime.

At present, developing country parties are not yet subject to substantive obligations, such as the reduction of GHGs emissions, under the current climate change regime. The majority of developing countries are minor emitters of the GHGs compared with the developed country Parties. However, if the ultimate objective of the FCCC, ie

the stabilisation of GHGs concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system, is to be achieved, developing countries will eventually need to undertake such substantive commitment. In addition, if the development process accelerates, in particular at a pace that has been witnessed in the newly industrialised countries²⁷, developing country Parties will soon become the major GHGs emitters as their economies continue to grow. As a result, developing countries need to develop in a sustainable way that minimises the threat to climate change. The present study thus puts forward suggestions in reforming the SAPs of the BWIs such as the “SAP with a climate safety net”. In addition, this thesis evaluates the innovative mechanisms of the World Bank and examines ways in which these innovative mechanisms should be developed if the goal of assisting the implementation of the FCCC is to be effectively achieved. At the end of this thesis, a brief case study will be conducted on four developing countries in South-east Asia²⁸, a region that, until recently, was held as a development model by the BWIs. The arguments and analysis proposed in this thesis are further tested in this case study.

By identifying the relevant issues as to how the BWIs can play their new role effectively, this thesis hopes to provoke further research and to make a contribution to the existing body of knowledge relating to the BWIs, as well as to the evolving field of study on climate change.

²⁶ The “climate change regime” refers to the FCCC and the Kyoto Protocol that has yet to come into force.

²⁷ Admittedly, the recent financial crisis in South-east and East Asia will slow their growth. Nevertheless, this does not necessarily mean that they will contribute less to the problem of climate change, for further discussion see Chapter 6.2.

1.2 Limitations of the present study

In order to narrow the scope of this thesis, certain limitations have been imposed. The main limitation is within the studies of the operations of the BWIs.

The BWIs undertake various types of operations²⁹, some of which are consultative and advisory in nature, such as the IMF consultation with its members, laid down in Article VIII Section 6 of the IMF Articles of Agreement. Others engage in lending activities, in particular in the World Bank³⁰. Each of these operations is capable, to a greater or lesser extent, of influencing the members' choice of development path. This thesis limits its study to only one traditional type of operation within the BWIs — structural adjustment lending. The main reason for this is to focus on the most relevant and, arguably, the most effective, existing mechanism the BWIs employed to influence their developing country members. The choice of structural adjustment lending over other types of lending mechanisms is based on the distinctive legal and quasi-legal instruments employed in structural adjustment lending, which include the nature of policy-based lending and the application of conditionality³¹. These legal and quasi-legal instruments give the BWIs greater leverage over the borrowing members in terms of their greater access to the decision-making process in the borrowing governments³². As a result, the adjustment-type lending and its SAPs have been the major mechanisms employed by the BWIs since the late 1970s and, in particular, in the 1980s to promote

²⁸ The four countries are Indonesia, Malaysia, Philippines, and Thailand. Reasons why these four have been selected will be described in Chapter 6.

²⁹ Chapter 2.1.2 will provide a brief outline of the types of operations of the IMF and the World Bank.

³⁰ Although much publicity has been generated about its lending activities, the primary function of the IMF is actually to provide "a permanent forum for consultation" (Bakker, 1996, p. 15).

³¹ Detailed discussion on programmatic and policy-based lending and conditionality will be conducted in Chapter 3.3 and 3.4.

³² For example, adjustment loans are usually used for correcting balance of payments deficit and "such loans directly affects the macroeconomic policy choices open to the borrowing country" (Mason and Asher, 1973, p. 430).

the traditional model of development that seeks to maximise economic growth. The scope of this thesis is therefore limited to structural adjustment lending when examining the operations of the BWIs.

Another limitation that needs to be noted concerns the discussion of the IMF. As mentioned earlier, the main function of the IMF is to provide a permanent forum for consultation to monitor the macroeconomic policies of its member states. However, this aspect of the operation of the IMF is not dealt with in this present study. As a result, discussion on the IMF is limited in the context of its role in SAPs. In addition, as the innovative mechanisms are developed, or are developing in the World Bank, the evaluation conducted and suggestions proposed relating to these new mechanisms focus exclusively on the World Bank. As the preceding section indicated, the two pillars of the present study are the governance structure of the BWIs and the interaction between the BWIs and the FCCC. In the case of the latter, discussion on the close link with the FCCC focuses on the World Bank because of the role it plays in GEF and other innovative mechanisms.

As noted earlier, a case study on developing countries has been conducted and four developing countries in South-east Asia have been selected. The reasons for that choice of region are as follows. Firstly, South-east Asia has been characterized as a “development model” by the BWIs. Despite the financial turmoil in the region in 1997-98, the lessons of the developing countries in South-east Asia after the 1980s are still held as a model when it comes to “development”, one in a more traditional sense that seeks to maximise “economic growth”. The economic path chosen by the governments in South-east Asia is the one promoted by the BWIs and, to a certain extent, guided by their SAPs in the 1980s. Secondly, the SAPs of the BWIs resulted not only in economic

transformation, but also in environmental transformation in the region³³, as illustrated in the present study. In addition, energy demand, in particular for fossil fuel, for their growing economies has been increasing so rapidly that South-east Asia will become a major GHGs emitter³⁴ in the future³⁵. As a result, the present economic structure might impede the governments' abilities to implement the FCCC, which would provide the World Bank with an excellent opportunity to experiment with its innovative mechanisms by assisting South-east Asian governments to implement the FCCC. For these reasons, South-east Asia is selected as the regional focus in this thesis. If these innovative mechanisms prove to be successful and efficient in encouraging South-east Asia to adopt a development path that takes into account climate change, these mechanisms might be applied more effectively to all the developing country members of the BWIs.

1.3 Structure of this thesis

There are seven chapters in this thesis. Following this introductory chapter, Chapter 2 focuses on the BWIs. A brief institutional account is provided in the first section and the obligations imposed on member states by the Articles of Agreements and loan documents are described. The second section examines the evolving relationship between the BWIs and their developing country members. It is divided into two subsections. The first looks at the relationship in the context of "economic" development, in which the BWIs provide their developing country members with financial and technical

³³ For example, deforestation is occurring faster in East Asia, including South-east Asia, than anywhere else in the world (Hammer and Shetty, 1995).

³⁴ For example, according to a World Bank study, if the past patterns of GHGs emission continue, East Asia, including South-east Asia will account for more than half of the World's incremental CO₂ and sulphur dioxide emissions (World Bank, 1993b), see Chapter 6.2.2 for further discussion.

assistance for the purpose of “economic” development. The issue of governance and asymmetry problem perceived by the developing countries are identified and discussed in this type of relationship. The second sub-section investigates a new dimension of this relationship after sustainable development emerged as a new development paradigm. As a result of this new development, the relationship becomes one in which the World Bank, one of the BWIs, provides assistance for a different purpose — to assist developing country members in implementing MEAs, in particular the FCCC.

Chapter 3 focuses on the SAPs and the legal and quasi-legal instruments employed by the BWIs to influence the developing countries. The legal and quasi-legal instruments associated with the SAPs in general are depicted in the discussion on the operational and legal aspects of the structural adjustment lending and programmes. The nature of programme and policy-based lending and the application of conditionality, in particular, are subject to separate and closer examination, and are followed by an investigation into the effectiveness of these legal and quasi-legal instruments in producing *outcome* and *impact*. For empirical research on the operations of the SAPs³⁵, this thesis draws upon existing literature by the BWIs and other institutions to analyse the effectiveness of the SAPs. The final section in Chapter 3 briefly revisits the relationship between the BWIs and the developing countries in the context of “economic” development, and looks at the implications of this relationship on the operations and effectiveness of the SAPs.

³⁵ The rate of growth might be retarded due to the recent financial crisis in this region. However, the impact of this financial crisis on the energy demand or environmental policies in this region remains uncertain. For further discussion, see Chapter 6.2.

³⁶ This is due to both the scope and time constraint of the thesis, and the limited expertise of the author to conduct economic empirical research. In addition, a large body of research work has been produced by both the staff of the BWIs and academic institutions.

Chapter 4 turns to an examination of the innovative mechanisms introduced by the World Bank after the 1990s. The establishment and operations of the following three mechanisms are introduced: GEF, the Bank AIJ programme, and the proposed GCI/PCF. Since GEF has the most operational experiences among these mechanisms, it is subject to separate discussion. The distinctive features of GEF in its decision-making rules and closer link with the FCCC in the forms of formal and informal arrangements are investigated. Furthermore, operations similar to the application of conditionality and policy-based lending are identified and comparison with the SAPs is made. Lastly, the new dimension of the relationship between the BWIs and the developing countries, identified in Chapter 2, is analysed in more detail in light of these innovative mechanisms, in particular, GEF.

On the basis of these early chapters, this thesis suggests that the SAPs of the BWIs, through various legal and quasi-legal instruments employed, might have achieved a certain degree of effectiveness in producing the changes of domestic laws and policies, ie an *outcome*. Nevertheless, the asymmetry treatment perceived by developing countries under the BWIs and its ramifications on the relationship between the BWIs and the developing countries might be one reason why the SAPs were not fully implemented and, as a result, undermined the effectiveness of the SAPs in producing the intended *impact*. The new dimension introduced by GEF through its novel governance structure to the interaction between the BWIs and the developing countries might mitigate the asymmetry problems perceived by the developing countries. This, as a result, might help the legal and quasi-legal instruments identified in GEF operations to increase their effectiveness in producing the desired *impact* in the recipient countries.

Chapter 5 looks at the FCCC in more detail. A brief account of the FCCC is provided from the outset. The interaction between the FCCC and the BWIs is then discussed, including the manner in which the existence of the FCCC and the Kyoto Protocol can affect the regular operations of the BWIs. The implications of the Kyoto Protocol for the World Bank are also examined. The following two sections examine and evaluate the operations of the BWIs that are relevant to the FCCC and the Kyoto Protocol. The third section scrutinises the SAPs operations in light of the FCCC and proposes a “climate safety net” as one possible reform to the design of the SAPs. The last section evaluates the operations of the World Bank’s innovative mechanisms and suggests future developments that can be made under the climate change regime.

Chapter 6 provides a brief case study of South-east Asia to put the arguments proposed in the present study to the test. A condensed account on the economic development in South-east Asia after World War II (WW II) and the role of the BWIs in this process of development are provided from the outset. The second section discusses the relationship between the FCCC and South-east Asia in the context of potential environmental, in particular, climate change, impact of the development path in this region. The last section explores the possibility of using the World Bank’s innovative mechanisms to assist South-east Asia in tackling the problems of climate change.

Chapter 7, the concluding chapter, briefly summarises the major findings and arguments of this thesis, offers concluding observations and looks forward to stimulate future research and discussion on the BWIs and climate change.

1.4 Methodology

The methodology this thesis adopts is mainly analysis of the academic discussions and official literature dealing with climate change, the BWIs, and sustainable development. Since it is a relatively new area of legal study, very little systemic academic research has been conducted and published. The sources of material rely on both official publications from the BWIs and research papers from NGOs conducting similar research, and materials published by relevant academic institutes. Due to the fundamental ideological differences between the BWIs and the NGOs, it is anticipated that conclusions reached in the research reports produced by these two groups rarely agree with each other. The analytical tool this thesis adopts to examine these reports is a law-based policy analysis, which assesses whether the policy conclusions have a sound legal basis. Furthermore, the interpretations and conclusions in these documents are treated with caution. Interviews have been used as a supplement to investigate the actual practices of the BWIs. Two short field trips were made to Washington DC for the purposes of visiting the Joint Library of the IMF and the World Bank to obtain materials that cannot be located in London, and of conducting interviews with BWIs and NGOs staff. Interviews were conducted with staff from the Environment Department and Legal Department of the World Bank, and the Legal Department of the IMF. In regard to NGOs, interviews were conducted with members from the following organisations: the World Wildlife Fund (USA) and the Environmental Defence Fund and from one Filipino NGO: the Asia-Pacific Forum of Environmental Journalists.

Difficulties arose regarding some methodological issues. First, very little literature was focused on the relationship between the IMF and the environment in

general and climate change, in particular³⁷. Most of the available literature is located within the economic discipline, focusing on the relationship between macroeconomics and the environment. It has been indicated that this thesis has limited its discussion of the IMF on the role it plays in the SAPs and literature relating to the role of the IMF in the SAPs abounds³⁸. Hence, it was anticipated that this gap in the existing literature on the IMF would not cause too many difficulties. Second, economic theories and principles, which were not legal, generate most of the debate around the operations of the BWIs, in particular concerning their adjustment lending operations³⁹. This thesis attempts to utilise the interpretations of all the relevant legal instruments, such as the Articles of Agreements of the BWIs and decisions of their organs, as a supplement to the debate. In addition, potential legal issues have been identified. For example, what are the legal implications of conditionality, and what is the binding character of treaty obligations for institutions whose members are parties to another treaty and so on. It was expected that these issues and the potential solutions would be the main contributions to the present thesis.

One more methodological issue concerns the use of the following terms in the operations of the BWIs: mechanisms, instruments, techniques, and tools. This thesis puts together a brief explanation and an example of each of these terms in Table 1-1.

³⁷ This is one of the reasons why the present study will put more emphasis on the World Bank, as pointed out in the preceding section.

³⁸ For example, the IMF itself has conducted several evaluation studies on its experiences under the ESAF. See, for example, Schadler et al, 1993; IMF, December 1997. Studies on the IMF and the SAPs were carried out by other institutions as well, such as Killick, 1995a and 1998.

³⁹ For example, Bird, 1995; Corbo and Fischer, 1991; Davis, 1992; Eichengreen and Kenen, 1994; Jayarajah and Branson, 1995; Killick, 1995a and 1998; Obstfeld, 1993; Singer, 1995; World Bank, 1988a and 1988b.

Table 1-1: Terms used in the BWIs operations

Terms	Examples	Explanations
Mechanism	Structural adjustment lending and programme, GEF, GCI	Has the broadest application, referring to a framework with institutional, procedural, and substantive aspects.
Instrument	Loan agreement, Policy Framework Paper, Letter of Development Policy	Has the more general application, referring both “mechanism” and “technique/tool”, as well as legal and semi-legal documents of governments or between government and the BWIs in a structural adjustment type lending.
Technique/tool	Conditionality, policy-based lending	Has the narrowest application, referring to specific, individual forms contained in the “mechanism”.

These terms are used interchangeably in some instances. For example, conditionality is a “technique/tool” used in the operations of the SAP and it is also a quasi-legal “instrument” employed by the BWIs to influence developing countries. Structural adjustment lending and programme are “mechanisms” of the BWIs to promote a particular model of development in their member states, but they are also legal “instruments” used to obtain leverage over developing countries. Nevertheless, the term “legal and quasi-legal ‘instruments’” is used most frequently in the present study to refer to all these mechanisms and techniques/tools employed by the BWIs to influence developing countries.

The 50th anniversary of the Bretton Woods Conference was celebrated in 1994, producing a rich literature and providing an excellent opportunity to examine the operations of the BWIs. Meanwhile, the FCCC has had five years of operations and, after intensive negotiations, has produced a significant Kyoto Protocol which, when in force,

will provide binding emissions targets for developed country Parties. All of these events shed light on the future direction that the BWIs will take in the 21st century. The purpose of this thesis is an attempt to provide some clues as to what future directions the BWIs can take in pursuit of sustainable development and in contributing to the global efforts used to tackle the threat of climate change. By identifying lessons to be learned from the previous experiences of the BWIs in promoting “economic” development, this thesis endeavours to offer insights as to how the BWIs can effectively play its new roles in assisting implementation of the FCCC.

CHAPTER 2: BRETTON WOODS INSTITUTIONS

This chapter will focus on the Bretton Woods Institutions (BWIs) and their relationship with developing countries. It will begin with a brief look at the histories of the BWIs, their present day operations and obligations for member states arising from the Articles of Agreement and the loan documents. The degree of flexibility in the operations of the BWIs, from their official amendment to their respective Articles of Agreements to utilising legal mechanisms such as trust funds to take on new mandates without undergoing cumbersome amendment procedures, will be emphasised. In addition, by examining the obligations of member states, the section sets the scene for a discussion on governance structure, which is perceived by developing countries as asymmetrical, and its implications on the relationship between the BWIs and their developing country members.

This relationship between the BWIs and the developing countries will be examined from two perspectives. The first will look at the traditional relationship in which the BWIs provide funding and policy advice for development purposes and the second at recent developments in the 1990s when the World Bank took a new role by channelling funding to developing countries for the purpose of implementing multilateral environmental agreements (MEAs).

The governance structure of the BWIs and the resulting asymmetry problems perceived by developing countries will be identified and examined in the context of the relationship between the BWIs and those countries. In addition, the increasing interaction between the BWIs and the MEAs, which results in the introduction of new mechanisms in the 1990s, will also be discussed briefly.

2.1 Brief introduction to the Bretton Woods Institutions

2.1.1 *Histories*¹

The protectionist policies of the major industrialised countries in the 1930s led to a chaotic international economic order and to World War II (WW II)². Under these circumstances, it was felt by economists and statesmen that international economic co-operation should be promoted and institutionalised. Meanwhile, as WW II was coming to an end, it was widely perceived that a large amount of financial assistance would be urgently needed to help the reconstruction and development of war-torn Europe and low income countries. That was the background leading to the 1944 Bretton Woods Conference held in New Hampshire, United States, at which the Articles of Agreements of the IMF and of the IBRD — the so-called Bretton Woods Institutions (BWIs) — were negotiated and concluded³. During the following five decades, the socio-economic context in which the BWIs operate has gone through various changes and the services required of the BWIs from their member states have been constantly changing. The two institutions have, thus, made several reforms accordingly.

2.1.1.1 *The IMF*

The purposes of the IMF, as laid down in Article I of the IMF's Articles of Agreement⁴, include to promote international monetary co-operation, to facilitate the

¹ This section will briefly outline the IMF's and the World Bank's major institutional reforms and the new mechanisms introduced in a chronological order. The flexibility of the BWIs in responding to new demand and in introducing new mechanisms can be noted at all times.

² The competitive currency devaluation and protectionist trade policies led to a contraction in world trade and the low income levels of the Great Depression during the 1930s (De Vries, 1986). The difficult economic situation in, for example, Germany brought discontent to the people and an unstable social and political situation, which contributed, partly, to the rise of Hitler.

³ There is a wealth of literature regarding the historical background of the Bretton Woods Conference, for example, De Vries, 1986; James, 1996; and Oliver, 1996.

⁴ 2 UNTS 39 (1947), as amended: 726 UNTS 266 (1976) and 29 UNTS 2203 (1978); reproduced in: Zamora and Brand, 1990.

expansion and balanced growth of international trade, to promote exchange stability and to give confidence to its members by making the general resources of the IMF temporarily available to them under adequate safeguards. The IMF has undergone various reforms by adopting amendments to its Articles of Agreements and introducing new facilities during the past five decades in response to the new development in the international monetary system and to the new demands of its members. These reforms are outlined in Table 2-1:

TABLE 2-1: IMF reform

Year	New facilities and Amendments	Purpose of the reform
1952	Stand-by arrangement ⁵	To make the resources of the IMF available to its members when difficulties arise with balance of payments.
1971	First Amendment and introduction of the SDR ⁶	To solve the international liquidity problem in the 1960s ⁷ .
1974	Oil facility	To assist its members in tackling two oil crises.
1963, 1975	Compensatory Financing Facility	To assist its members who faces a shortfall in export earning due to factors beyond their control.
1975	Extended Fund Facility (EFF)	To supplement the short-term nature one-year stand-by arrangement when members face serious structural balance of payments difficulties and require more time to adjust (James, 1996).
1976	Trust Fund	To assist the poorest developing country members and to supplement the high interest rate oil facility by providing this low interest rate fund.

⁵ Decision No 270-(53/95) 23 December 1953, as amended by Decision Nos 876-(59/15), 27 April 1959. and 1151-(61/6), 20 February 1961 (IMF, June 1997).

⁶ The allocation, use and operation of the SDR are set out in Article XV-XXV of the Articles of Agreement of the IMF, the detail discussion of which is omitted here due to the scope and the relevance of the thesis. For a more general account on the SDR, see James, 1996; and Dam, 1982.

⁷ International liquidity is the total of international reserves held by all countries plus credit available from the IMF. The liquidity problem in the 1960s refers to the situation in which international trade expanded in such a rapid pace that the existing reserves were insufficient to cope and that additional reserves were required (Dam, 1982).

1978	Second Amendment ⁸ : official sanction of floating system, introducing surveillance into the IMF's operation	To respond to the reality where most of its members already operate a floating system ⁹ and to continue monitoring the international monetary system by installing the surveillance mechanism.
1986	Structural Adjustment Facility (SAF)	To address a more fundamental structural problems in its members encountering acute debt problems in the 1980s ¹⁰ (Bretton Woods Commission, 1994).
1987	Enhanced Structural Adjustment Facility ¹¹ (ESAF)	To supplement the SAF by providing larger funding to its poorest members for a longer period.
1992	Systematic Transformation Facility (STF)	To assist the former central planning economies in their transfer to market-based economies (James, 1996).
1993	Third Amendment: strengthen compliance	To address its members' non-compliance problems, by authorising the IMF to suspend members' voting rights in case of non-compliance ¹² .
1997	Supplementary Reserve Facility (SRF)	To assist member states experiencing balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and members' reserve ¹³ .

⁸ For the discussion on the negotiation, significance and impact of the Second Amendment to the IMF's Articles of Agreement, see James, 1996; and De Vries, 1986.

⁹ The whole event was triggered by the US's announcement to suspend the convertibility of officially held US dollars into gold in August 1971, which led to the end of the classic Bretton Woods system since the two main features of the system — par values and dollar convertibility — were, as a result, no longer operative. For a more detailed discussion on the relationship between the US dollar convertibility and the fixed exchange rate system under the original IMF Articles of Agreement, see, for example, James, 1996.

¹⁰ The cause of the debt crisis and its impact on the BWIs, the commercial banks and debtor countries will not be discussed here as they are not relevant to the thesis and due to the existing extensive literature on the topic. See, for example, James, 1996.

¹¹ The SAF was phased out in 1994–95, leaving the ESAF as the IMF's only adjustment-type lending. More detailed discussion on these two facilities will be conducted in Chapters 3.

¹² Under the original Articles, the IMF usually seeks to end the violations of the Articles through consultations with officials of the offending member country. In addition, under Article XXVI, Section 2(a), the IMF can formally declare a member "ineligible" to use the IMF's general financial resources. Furthermore, under Section 2(b), the offending member can be expelled from the IMF. The new method introduced by the Third Amendment lies in between these two sanctions. See: 31 ILM 1307-11 (1992) for the full text of the Third Amendment.

¹³ This Facility was approved by the IMF Executive Board in December 1997, mainly as a response to the large financial assistance needed in South-east and East Asia because of the financial crisis in the second half of 1997. South Korea was the first member state to receive assistance under this Facility.

From Table 2-1, it can be seen that the IMF's operations have gone through various and, at times, drastic reforms during the last 50 years. Although its mandates, as prescribed in Article I, remain the same, its Articles of Agreements have undergone three amendments during the last five decades to accommodate external changes and internal demands from its member states. In addition, by adopting the Board of Executive Directors' decisions, new financing mechanisms ("facilities") of different terms for different members and with different purposes have been established from time to time. All these illustrate how flexible the IMF has been in responding to the external demand, ie changes in the international socio-economic environment¹⁴ and internal demand, ie different needs of its members at different development stages. The Second Amendments to the Articles of Agreement, which acknowledges the floating exchange rate system practised by most of its member states, is an example of the former; while the introduction of the EFF, SAF and ESAF as a response to the long-term need of some of its developing country members is an example of the latter.

After the onset of the South-east Asian and Korean financial crisis in 1997–98, which the IMF was unable to predict in its 1997 World Economy Outlook, the effectiveness of the IMF's rescue package remains unknown and demand for reforming the IMF mounted (eg *The Economist*, April and October 1998; Sachs, 1997). The IMF's Executive Board, partly in response to this demand, passed the decision to set up a new financial mechanism — the SRF — at the end of 1997. At present, it remains too early to predict whether reforms will be undertaken more widely within the IMF's operations¹⁵.

¹⁴ The changing socio-economic environment does not refer to any particular event at any particular period of time. It simply refers to the international setting in which interaction among countries and their economic activities take place and is constantly changing according to, for example, political or economic changes internationally and domestically.

¹⁵ Discussions have taken place and opinions exchanged as to whether, or how the IMF's role should be reexamined in coping with the series of financial crisis that began in South-east Asia in 1997.

2.1.1.2 The World Bank

The purposes of the IBRD, as laid down in its Articles of Agreement¹⁶, include to assist in the reconstruction and development of its members' territories and to promote the long-range balanced growth of international trade and the maintenance of equilibrium in balance of payments. The IBRD is part of the World Bank Group. Like the IMF, the institutions within and operations of the World Bank Group have expanded in the last 50 years and the reforms are outlined in Table 2-2.

TABLE 2-2: World Bank reform

Year	New institutions and lending operations	Purpose of the reform
New institutions		
1945	International Bank for Reconstruction and Development (IBRD)	To restore the war-torn Europe and to promote development in its member states.
1956	International Finance Corporation (IFC) ^{17, 18}	To revive the very sluggish private capital market in the early 1950s and to encourage private investment domestically as well as internationally.
1960	International Development Association (IDA) ^{19, 20}	To meet the needs of the less developed country members by establishing the IDA to provide more concessional financial and technical assistance.
1966	International Center for Settlement of Investment Dispute (ICSID) ²¹	To provide a conciliation and arbitration service for investment disputes between foreign investors and host governments.

Nevertheless, as pointed out in the previous chapter, the discussion of the IMF in the present study will only focus on its structural adjustment-related operations. Since most of the recent discussion is concerned with issues such as financial market and capital movement, it will not be dealt with in the present study.

¹⁶ 2 UNTS 39 (1947), as amended: 17 December 1965, 2 UNTS 134; reproduced in: Mutharika, 1978.

¹⁷ The IFC charter came into force on 20 July 1956. 264 UNTS 117 (1957).

¹⁸ For a more recent development on the operations and role of the IFC, see Ryrie, 1995.

¹⁹ The IDA charter came into force on 24 September 1960. 439 UNTS 249 (1962).

²⁰ For a more detail account on the negotiation and operations of the IDA, see: Mason and Asher, 1973.

²¹ The Convention on the Settlement of Investment Disputes between States and Nationals of other States came into force on 14 October 1966 and established the ICSID: 575 UNTS 159 (1965).

1988	Multilateral Investment Guarantee Agency (MIGA)	To provide insurance against non-commercial investment risk and technical services that help to promote investment flows.
1991	Global Environment Facility — pilot phase (GEF P) ²²	To respond to the increasing financial needs of its developing country members to implement MEAs.
1993	Inspection Panel ²³	To respond to the complaints from those affected by the Bank's project by creating the Panel to investigate such private complaints about the Bank's operations ²⁴
1994	Global Environment Facility — restructured (GEF I) ²⁵	To meet the requirements of the FCCC, Convention Biological Diversity (CBD) and Agenda 21 to serve as their financial mechanism.
LENDING OPERATIONS		
Be-fore 1980s	Mainly project lending	To comply with the IBRD's Articles of Agreement which stipulates that loans made by the Bank shall be for the purpose of specific projects of reconstruction or development ²⁶
After 1980s	Beginning to engage in more programme lending and introducing Structural Adjustment Loan (SAL), Sectoral Adjustment Loan (SECAL) and, Sector Investment Programmes (SIPs) ²⁷	To assist its members in dealing with structural and sectoral problems when the macroeconomic environment and the resulting difficult balance of payments position endangered the effectiveness of the Bank's project lending operations (Reed, 1992) ²⁸ .

From Table 2-2, it can be seen that the Bank, similar to the IMF, has been flexible enough to undertake various reforms. While the IBRD's Articles of Agreement have not

²² World Bank Resolution 91-5 Establishment of GEF, April 1991, 30 ILM 1735-54, 1991.

²³ The Resolution of the Executive Directors establishing the Inspection Panel (Resolution No. 93-10 & Resolution No. IDA 93-6); reproduced at 34 ILM 520, 1995.

²⁴ For a more detailed account on the establishment and operations of the Inspection Panel, see Shihata, 1994b. The impact and significance of the Inspection Panel will be discussed in greater detail in the following section.

²⁵ Instrument for the Establishment of the Restructured Global Environment Facility, reproduced at 33 ILM 1283, 1994.

²⁶ Article III, Section 4(vii) states that: "Loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development".

²⁷ The SIPs operate differently from the SAL/SECAL in that donor countries are called upon to coordinate their development assistance in a particular sector in the programme countries. The SIPs, thus, will not be looked at in this study. For more discussion on the SIPs, see: Okidegbe, 1997.

²⁸ More detailed discussion on the operation of SALs and SECALs will be conducted in Chapters 3.

adopted as many amendments as that of the IMF, member states and management of the Bank were innovative enough to establish new institutions, including, for example, an Inspection Panel that was held to be the first such dispute settlement mechanism in any international and/or regional development and financial organisation. In addition, the management of the Bank was flexible enough to interpret the language of the original Articles of Agreement to expand the lending scope of the Bank in order to engage in programme and policy-based loans after the 1980s. Furthermore, the Bank, as will be discussed in more detail later, has borrowed legal mechanisms such as trust funds to take on new mandates as demand arose without going through cumbersome amendment procedures to the Articles of Agreement.

2.1.2 Present day operations

After a brief account of the historical development of the BWIs, this section will look at their operations. As previously mentioned, both of the BWIs have undergone various reforms in the last five decades. This section will only delineate the present day operations of the BWIs.

2.1.2.1 The IMF

The two main operations of the IMF are to engage in regular consultation with the member states and to provide financial assistance to member states through various mechanisms.

After the Second Amendment to the Articles of Agreement came into force, it is the legal duty of the IMF to exercise “firm” surveillance over the policies of its member

states²⁹. The IMF usually sends a team of staff to member states on a regular basis to engage in consultation with officials. The purpose of the surveillance mechanism is to monitor macroeconomic policies of the member states, such as their exchange arrangements³⁰. Surveillance activity is gradually becoming the main operation of the IMF. For example, it estimated that the cost to carry out its surveillance activity in the fiscal year 1998 is more than one-fourth of all the costs of its major activities³¹.

However, financial assistance provided by the IMF to its members through its various mechanisms remains top of the agenda, as attested by the emergency assistance provided to the troubled South-east Asian members and South Korea in the second half of 1997³². One of the IMF's purposes, as laid down in its Articles of Agreement, is "to give confidence to members by making the general resources of the IMF temporarily available to them under adequate safeguards ..." (Article I.)

Using the IMF's terminology, a member that has balance of payments difficulties can use its own currency to purchase another member's currency from the IMF³³. After a certain period of time the borrowing member is obliged to buy back its own currency with another member's currency designated by the IMF³⁴. Whether the purchase comes with conditions depends on the facility or mechanism the member uses to draw from the IMF. The scale of conditionalities is largely determined by the relative amount of money

²⁹ Article IV, Section 3(b) states that: "In order to fulfill its functions under (a) above, the IMF *shall exercise firm surveillance* over the exchange rate policies of members and shall adopt specific principles for the guidance of all members with respect to those policies." (emphasis added.)

³⁰ For a discussion on the IMF's role in maintaining orderly exchange arrangements and facilitating multilateral payments, see: Fieleke, 1994.

³¹ The estimated cost of surveillance takes up 28.5%; while that of its lending activity ("Use of Fund Resources" should be the correct term) is about 21.1% (IMF, 1998a).

³² However, some commentators remain skeptical about the role of the IMF and the effectiveness of the programme prescribed by the IMF in a situation like this. See, for example, Sachs, 1997; Lacayo, 1997.

³³ This is called "currency swap" in IMF terminology. Note that the operations of the SAF and ESAF do not involve a currency swap. For more discussion of the SAF/ESAF, see Chapter 3.2.2 and 3.2.3.

a member draws. Different type of facility allows members to draw a different percentage of their IMF quota. A facility that allows members to draw larger percentage of their IMF quota usually prescribes more stringent conditions for the borrowing members³⁵. Members have almost unconditional access to the “reserve tranche”, which is part of the country’s own reserves that it keeps on deposit with the IMF. In addition, the member can reach an agreement with the IMF to draw (borrow) four further “credit tranches”, each equivalent to 25% of its quota. The first tranche, which is the first 25% of its quota, is with least stringent conditions. After the first tranche, the other three bring much more stringent conditions to the member. Meanwhile, conditionalities differ as well depending on through which facility does the IMF provide its resources³⁶.

Through the regular consultation conducted with the member states, the IMF has been able to take part in examining the economic policies of its member states. The conditionality requirement for access to the IMF’s resources has given the IMF much leverage over its member states through the participation of “designing” the state’s economic policies using its resources. The IMF has been able to exercise a certain degree of influence through both these operations, in particular the application of conditionality. The practice of conditionality has become a sensitive issue since the 1960s (James, 1998), and more discussion on the implication of conditionality will follow in the preceding chapter.

³⁴ For the IMF’s operations and transactions, see Article V, in particular Section 3 (conditions governing use of the IMF’s general resources), Section 5 (ineligibility to use the IMF’s general resources), and Section 7 (repurchase by a member of its currency held by the IMF).

³⁵ For example, under the SAF, members are allowed to draw up to 70% of their IMF quota; while in the case of the ESAF, members are allowed to draw up to 250% of their IMF quota. As a result, ESAF has more stringent conditions than SAF.

2.1.2.2 *The World Bank: IBRD and IDA*³⁷

The main operations of the World Bank (IBRD and IDA) are to provide loans and technical assistance to its member states. In addition, the Bank also hosts various trusts, some of which serve environmental purposes³⁸. The combination of its financial and advisory roles has given the World Bank a certain degree of influence over its members, just as the IMF has been able to influence its members in the same manner. However, the emphasis accorded to different roles varies according to an individual country's needs and circumstances (World Bank, 1994).

There are five types of loans provided by the Bank to its members. The first type is specific investment loans for projects, which are the typical and most traditional type of loans as laid down in the Articles of Agreement (Article III, Section 4[vii] of the IBRD Articles of Agreement). The second type is a sector loan, eg Sectoral Adjustment Loans, which addresses policies such as input and output prices and lending rates for the sector being assisted. The third type is the Structural Adjustment Loan (SAL) and was set up in 1980 to deal with macroeconomic policy programmes and institutional changes necessary to modify the structure of the economy. The purpose of the Structural Adjustment Programme (SAP) is for the economy to achieve and maintain an appropriate growth rate and the viability of its balance of payments in the medium term with emphasis on sectors in which adjustment is considered to be most urgent. The last two

³⁶ For more discussion on the IMF's conditionality, see Chapter 3.4.

³⁷ This sub-section will only discuss the operations of the IBRD and IDA. The IFC performs a similar task; however, the entities to whom its services are provided are private parties. As for MIGA and ICSID, both of them have different types of operations than those of the IBRD and IDA.

³⁸ These trust funds include, for example, Global Environment Trust Fund (of the pilot phase Global Environment Facility), Ozone Projects Trust Fund (transferred from the Multilateral Fund of the Montreal Protocol), and the Rain Forest Trust Fund. For more discussion on the role of the World Bank as the trustee of these various funds, see: Sand, 1995.

types are technical assistance loans for institution building and support; and emergency reconstruction loans (Silard, 1989).

In addition to lending activity, the World Bank also engages in activities that provide technical assistance to its members. Although the IBRD's Articles of Agreement do not contain provisions for technical assistance, the Bank soon realised that its less developed members lacked the expertise to present well-prepared project proposals and that some assistance from the Bank was needed. As a result, technical assistance in project identification and preparation and other investment-related activities have been increasing steadily (Mason and Asher, 1973, chapter 10).

Apart from providing technical assistance to its members, another of the Bank's operation that is not laid down in its Articles of Agreement is to act as a trustee of various trust funds established by agreements between the Bank and the donors. The creation of a trust fund hosted by an international organisation has been practised for a long time. The IMF, for example, set up a Trust Fund in 1976 to assist some of its poorest members by providing them loans on concessionary terms³⁹. The Bank is not a newcomer in this area and had established a trust fund from as early as 1960⁴⁰. It has now hosted more than 1,500 trust funds⁴¹ (Shihata, 1994b).

The creation of trust funds administered by existing international organisations avoids the need to establish new organisations with limited purposes and makes use of the experience and expertise of the existing organisations (Gold, 1978). Both the Bank and the IMF have been able to take advantage of this and entered into agreements with

³⁹ For more discussion on the IMF's 1976 Trust Fund, see: Gold, 1978.

⁴⁰ In 1960, the Bank entered into an agreement with a number of governments that provides for the creation and administration of the Indus Basin Development Fund, the purpose of which is the effective utilisation by Pakistan of the waters assigned to it by the Indus Waters Treaty 1960 (Gold, 1978).

⁴¹ For detailed discussion on the Bank's trust funds, see its OP 14.40 of February 1997 which provides operational policies regarding trust funds administered by the Bank.

donors to set up trust funds for different purposes. This, again, illustrates the flexibility of the BWIs in coping with new demands.

2.1.3 *Obligations of the member states*

This section will discuss the obligations of the BWIs' member states. Treaty obligations arise when a country becomes a member of the BWIs and, as a result, agrees to abide by the Articles of Agreements of the institutions. A second set of obligations will only arise when member states make use of the BWI's financial resources, through loan documentation with different legal effect. The former type of treaty obligations, obligations under the Articles of Agreements, gives less cause for discontent because, firstly, countries are aware of these obligations when they become members and, secondly, these treaty obligations are prescribed in more general terms. On the other hand, the latter set of obligations, the loan obligations, sometimes cause tension between the BWIs and the borrowing member because the conditions attached to the loans are "probably not feasible or desirable" (Gold, 1984, p. 825)⁴².

By examining the members' obligations to the BWIs under both the Articles of Agreements and specific loan documents, this discussion will put the relationship between the BWIs and their members into context and demonstrate the leverage the BWIs have over their members, in particular developing country members. In addition, as will be seen at the end of the discussion, developing countries, because they use the institutions' financial resources more frequently, bear heavier obligations under the loan agreements and decisions of the Executive Boards relating to lending operations in the

⁴² This comment by Gold was made in the context of the IMF's conditionality. Nevertheless, the same sentiment can be equally observed in the case of the Bank's conditionality since under both institutions, "countries are not asked to subscribed to such a code [of conditionality] by becoming members ..." (Gold, 1984, pp. 825–26).

BWIs than “donor countries”, ie developed countries. Furthermore, the governance structure of the BWIs that affects the ways in which these obligations are designed and imposed, gave rise to an asymmetry problem widely perceived by the developing countries⁴³. As a result, the BWIs seem to have more influence over the developing country members. Before looking at the relationship with the developing countries, this section will first outline the two types of obligations briefly.

2.1.3.1 Obligations under the Articles of Agreement

The respective Articles of Agreements, by which the BWIs were created, govern the mutual rights and obligations of the BWIs and their members and those of members inter se, arising out of membership. The relationship is, thus, one of international law and treaty law (Broches, 1980)⁴⁴.

A. IMF

The general obligations of the member states of the IMF are regulated in Article VIII of the Articles of Agreement, which includes, inter alia, avoidance of restrictions on current payments and of discriminatory currency practices, convertibility and consultation. Other specific obligations relating to, for example, exchange arrangements (Article IV) and drawing from the IMF (Article V) are set down in sections throughout the Articles of Agreement. For members who are participants in the Special Drawing Rights Department, ie those that have been allocated the SDR, obligations regarding their

⁴³ Developing countries have long complained that their interests are not adequately expressed within the BWIs and, through forum and bodies such as the UN Conference on Trade and Development (UNCTAD) and G-77, have sought to change the current weighted voting system to a voting system that resembles the UN style voting. For more discussion, see, for example, Ferguson, 1988, and Gold, 1972.

⁴⁴ Broches was discussing the relationship between the World Bank and its member states. However, the same can be applied mutatis mutandis to the IMF and its member states in the same context.

participation in the SDR Department are further set down in Article XXII and other related provisions. Interpretations of the Articles (Article XXIX), over which the Executive Board and the Board of Governors of the IMF enjoy the exclusive power⁴⁵, might contain obligations for members as well.

In addition to the provisions in the Articles of Agreement, certain obligations are provided in the guidelines and decisions, in particular those regulating the use of the IMF's resources and creating new facilities, approved by the Board of Executive Directors. Theoretically, these obligations are applicable to all members, as opposed to those arising from specific "drawings" (loans) that are only applicable to the borrowing members. In practice, however, members that rarely use the IMF's resources are not affected by this type of obligation, leaving those members who regularly need to turn to the IMF for financial assistance the only subject to which these obligations apply. The last drawing from a developed country member was made by the United Kingdom in 1977, which meant that the developing countries fell in the latter category⁴⁶. The implications of this asymmetry will be looked at in the next section.

B. IBRD

While the IMF is more of a regulatory institution⁴⁷, the IBRD is designed to be more like a commercial bank that provides services to its clients. As a result, the obligations of the IBRD's member states, stated in its Articles of Agreement are less

⁴⁵ If a question of interpretation of provisions of the Articles arises between any member and the IMF, or between members, the Boards of Governors and Executive Directors of the IMF is empowered to interpret its Articles authoritatively, that is to say, with finality and binding effect for members and the IMF. This power is an exclusive one, because members are precluded from resort to some external tribunal when questions within either of these two categories arise (Gold, 1984 and 1996).

⁴⁶ One of the OCED countries, South Korea, drew from the IMF's Supplementary Reserve Facility in 1998. Nevertheless, access to the SRF is for exceptional circumstances. Most of the facilities, such as the ESAF, allow only the poorest developing country members to have access to it.

comprehensive than those laid down in the IMF's. For example, the IBRD's Articles of Agreement do not have provisions equivalent to Article VIII of the IMF's Articles of Agreement, whereby the general obligations of the members are prescribed. The main treaty obligations provided by the IBRD's Articles of Agreement are to subscribe shares of the capital stock of the Bank and to make a minimum payment⁴⁸ of the subscribed share (Article II, Section 3, 5 and 7). Another main obligation for IBRD members is to guarantee the repayment of the principal, interest and other charges on the loans made by the Bank to the public entity in its territory (Article III, Section 4[i]).

As with the IMF, the Bank's Board of Executive Directors has adopted operational procedures and manuals from time to time. However, these procedures and manuals usually set out guidelines to the Bank's staff, rather than to members, in making loans. Bank members who borrow from the Bank are not subject to these operational procedures. These operational procedures and manuals are designed for a speedier process of the loans and are supposed to be beneficial to the borrowing members. With the establishment of the Inspection Panel in 1993, citizens in the territory of a member state who are likely to be affected by the Bank projects can bring complaints before the Panel in cases where the Bank has allegedly fail to comply with its operational procedures. While the borrowing government itself is not eligible to bring complaints to the Inspection Panel⁴⁹, this complaint system was set up to investigate and, therefore, to

⁴⁷ According to Gold, the IMF "is a regulatory organization in the sense that it can decide that certain exchange practices of a member are or are not consistent with the treaty" (Gold, 1996, p.xxix).

⁴⁸ 20% of a member's subscribed share shall be paid or subject to call as needed by the Bank for its operations (Article II, Section 5). Among the 20%, 2% of the price of each share is to be paid in by gold or United States dollars and, when calls are made, the remaining 18% shall be paid in the currency of the member (Article II, Section 7).

⁴⁹ While it is not explicitly mentioned in the Resolution Establishing the Inspection Panel, it is implied that the "affected party" can not be the borrower itself. Standard Bank loan agreements usually provide that disputes arising under them between the Bank and the borrower are to be settled by negotiation and, failing this, by arbitration (Shihata, 1994b).

ensure that Bank staff comply with all these operational procedures and manuals when preparing and implementing any Bank loan.

Overall, obligations derived from the Articles of Agreements and from the decisions of the Boards of Executive Directors with regard to the interpretations of the Articles of Agreements apply to all member states of the BWIs. Decisions of the Boards relating to loan operations, on the other hand, affect borrowing members, developing country members at present, more deeply since they are the main group to which these decisions apply. An important aspect of the obligations arising from the Articles of Agreements is to make contribution to the BWIs according to the quotas and shares prescribed. Developed countries are required to make more contribution to the BWIs as a result of their larger quotas and shares in the institutions and bear heavier burdens in terms of putting in more resources⁵⁰. Nevertheless, this is an obligation countries are aware of when they made the decisions to become member states of the BWIs. Furthermore, developed countries are designated with more votes and have access to larger amount of the resources because of their larger quotas and shares within the BWIs⁵¹.

Developing countries are the main subjects of the decisions of the Executive Boards relating to loan operations. However, in the present governance structure of both of the BWIs where weighted voting system is the rule, developing countries do not have votes sufficient to influence the ways in which these decisions are reached at the Boards

⁵⁰ This is more so in the case of the IMF where the review of the existing quotas of the member states take place on a regular basis (usually five years). Developed countries usually are required to make increased contributions to the IMF as a result of this review.

⁵¹ In addition, the five countries that make the largest contributions are entitled each to appoint an Executive Director.

of Executive Directors⁵². Although the Boards usually adopt decisions on the basis of consensus and very few formal votes are ever taken by the Executive Boards (Lister, 1984, cited in Stiles, 1991). The meaning of consensus can be referred to as “the sense of the meeting of the Executive Board”⁵³. It is noted by one commentator that: “The definition of ‘the sense of the meeting’, adopted by the Executive Directors in 1947, however, underscored that *the voting strength of members remains a crucial consideration with regard to the evaluation of consensus on any matters.*” (Ferguson, 1988, p. 65⁵⁴.) In addition, according to another commentator, one plausible reason why poor countries avoid voting to take place might be: “to ensure that they are not on the record as opposing policies approved by developed nations.”⁵⁵ (Ekchaus, 1986, cited in Stiles, 1991, p. 37.) Therefore, even though formal votes rarely take place and consensus is sought instead, developed countries can still dominate the decision-making process by virtue of their voting strength as a group on the Board.

As a result, developing countries might have felt being treated asymmetrically due to the fact that they are the only group of member states required to undertake heavier obligations from the decisions relating to loan operations of the Boards⁵⁶, over

⁵² For example, 24 OECD countries out of a total 181 IMF members have more than 61% of the total quotas allocated by the IMF to its members as of FY 1998.

⁵³ The rules for voting are prescribed in the paragraphs C-10 to C-12 in *Rules and Regulations* of the IMF. According to paragraph C-10: “The Chairman [of the Executive Board] shall ordinarily ascertain the sense of the meeting in lieu of a formal vote.” (IMF, January 1997, p. 23.)

⁵⁴ “The sense of the meeting” is explicitly defined by the Directors in 1947 to be: “a position supported by those Directors having sufficient votes to carry the question if a veto were to be taken.” (cited in: Ferguson, 1988, p. 65.)

⁵⁵ Developing countries of course can object to certain policies approved or favoured by developed countries. Nevertheless, they fear the possible retribution on the day that they themselves might seek assistance from the IMF (Stiles, 1991).

⁵⁶ Killick, for example, identified two forms of unequal treatment that has affected the effectiveness of conditionality. One occurs among borrowing countries where, due to lobbying from major shareholder governments, certain developing countries can receive better treatment than others do. The second form of unequal treatment is one of “asymmetry between developing and developed countries, with the former required to endure a degree of BWI involvement in policy formation that would not be tolerated for a moment by OCED governments, who routinely discount the ‘surveillance’ advice of the IMF.” (Killick, T, 1995b, p. 33.)

which, formally as well as in practice, they have less control compared with developed countries. The affect on the relationship between the BWIs and their developing countries members will be discussed after we examine another set of obligations for the member states of the BWIs, ie obligations arising from loans.

2.1.3.2 Loan obligations⁵⁷

A. IMF

The major difference between an IMF's "arrangement" and a World Bank's⁵⁸ "loan" is that the former does not constitute an international treaty between the IMF and its member; (Gold, 1970 and 1982), while the latter is an international treaty between the Bank and the borrowing government (Broches, 1959 and 1980). However, the legal characteristics should not be confused with the functional reality, in which conditions set down in either the IMF's arrangements or Bank's loans carry significant implications⁵⁹.

In the case of the IMF, obligations of the borrowing members, ie members that draw from the IMF, to remain in consultation with the IMF, to pay charges, and to repurchase in certain circumstances or at certain times are relevant to the IMF's arrangement with the members. However, these are derived not from the loan arrangement made with the IMF but from the provisions of the Articles of Agreement or the general decisions of the IMF (Gold, 1980c). A member that wishes to use the IMF's resources needs to present it with a "Letter of Intent", which sets out policies to correct its balance of payments difficulties. The Letter of Intent is usually heavily negotiated

⁵⁷ The "loan" obligations here also refers to the conditions in the IMF's stand-by arrangement and the Letters of Intent of the governments who draw from the IMF.

⁵⁸ Observations made here to World Bank loans apply generally to loans made both by IBRD and IDA. Note that in the IDA, the term "credit" is used instead of "loan".

between the IMF staff and the government. The Board of Executive Directors, after reviewing and discussing the context of the Letter of Intent, decides whether to grant the member's request. Neither the Letters of Intent nor the decisions of the Executive Directors are considered by the IMF to be documents creating contractual obligations for the members. In addition, the member's Letter of Intent is not considered a unilateral declaration that creates obligations on the member to pursue its announced policies (Gold, 1980a). Does this mean that there are no contractual obligations on the part of Fund's members who draw from the IMF? In a formal legal sense, this might be the case since there is no contract of any sort between the IMF and the member requesting a purchase. However, in practice, failure to comply with the performance criteria⁶⁰ set down in the Letter of Intent can result in the suspension of releasing the subsequent tranches^{61, 62}. Hence, members who draw from the IMF are under obligations arising from the Letter of Intent or any similar instruments in making arrangement with the IMF.

B. IBRD

In the IBRD's case, every loan agreement between the Bank and a member state is considered an international agreement, a treaty in the broad sense of the term and, as

⁵⁹ As one commentator puts it: "Legal formalism should not allow the international financial institutions to escape responsibility for the consequences of their actions in these processes." (Bradlow and Grossman, 1995, p. 428.)

⁶⁰ Performance criteria, usually expressed in quantitative indicators of certain economic criteria, refer to the terms on which the IMF will permit the member to use, and continue to use, the IMF's resources.

⁶¹ The language that specifies the performance criteria usually states that, in the event of non-observance, the member will not be able to engage in exchange transactions "except after reaching understandings with the IMF regarding the circumstances in which such purchases may be made." However, since it is the member who decides whether or not to consult with the IMF for the purpose of receiving the subsequent tranches, this language is not to be considered contractual (Gold, 1980c).

⁶² For more discussion on the implications of performance criteria and conditionality, see Chapter 3.4.

such, is registered with the UN⁶³ (Head, JW, 1996). As a result, the borrowing government is under a legal obligation to fulfil the conditions laid down in the loan agreement. The Bank's loan agreements typically include covenants or schedules detailing undertakings made by the borrower regarding the implementation of the project or programme involved. Such loan agreements represent the main instruments through which the Bank ensures that the relevant conditions are agreed upon in a clear and binding manner (Shihata, 1995, chapter 17).

The loan obligations of the member, thus, refer to those negotiated undertakings provided in covenants or schedules of the loan agreement⁶⁴. As part of its close, ongoing relationship with borrowers, the Bank has rarely conditioned the availability of future loans on compliance with current loan conditions, nor has it suspended loan disbursements to encourage compliance with current loans (Guyett, 1992)⁶⁵. An arbitration clause is usually included in the Bank's loan agreement in which dispute that has not been settled by the agreement will be subject to binding arbitration. However, there has been no incident where either the Bank or the borrowing member has invoked the arbitration clause regarding non-compliance with the loan obligations⁶⁶. Nevertheless, failure to comply with the loan obligations carries legal consequences, such as the shortened period for repayment, as well as practical consequences, such as the potential difficulties in obtaining future loans from the Bank and from the private sources⁶⁷.

⁶³ Article 102, para. 1 of the United Nations Charter states that: "Every treaty and every international agreement entered into by any member of the United Nations after the present Charter comes into force shall as soon as possible be registered with the Secretariat and published by it."

⁶⁴ The loan agreements referred to here are those for the financing of a specific project or programme. The guarantee agreements are not included since the nature of the borrowing government's obligations are different from those in a loan agreement.

⁶⁵ This is particularly in the case of environmental covenants (Guyett, 1992).

⁶⁶ Personal communication with a staff member in the Bank's Legal Department.

⁶⁷ For more detailed discussion on the international legal aspect of World Bank's loan and guarantee agreements with its members, see Broches, 1959.

Another type of loan agreement exists in both the IMF and the IBRD — the loan agreements between the IMF and the Bank and donors in setting up trust funds that are administered by the former⁶⁸. In this type of agreement, loan obligations will be imposed on both the IMF and the Bank and the donors, which, in most of the cases, are developed country members and are applicable mainly to the developed country members. However, such loan obligations mainly concern the contribution the donors intend to make and the associated issues, such as method of payment and financial terms. In addition, the BWIs usually do not impose any conditions on the part of the donors in this type of loan agreement since the BWIs themselves are the borrowers. Considering the focus of this chapter is on loan obligations agreed between the BWIs and their borrowing members, this type of loan agreement and the ensuing loan obligations will not be the subject of the present discussion.

To conclude, it is clear that the treaty obligations of member states arising from the Articles of Agreements are applicable to all members, developed as well developing ones. On the other hand, loan obligations and obligations derived from decisions of the respective Board of Executive Directors of the BWIs relating to loan operations mainly apply to members who borrow from the BWIs, which are all developing country members after 1980. One might argue that developing countries have the option of declining loans from the BWIs since they are clearly aware of obligations arising from such loans. Nevertheless, it is precisely such awareness among developing countries that result in the present situation where only countries in serious debt servicing problems

⁶⁸ For example, the operations of the IMF's ESAF are financed mainly from contributions from Fund members in the form of loans and grants to the ESAF Trust, which is administered by the IMF. In the case of the World Bank, OP14.40 on Trust Fund states that: "A trust fund is a fund administered by the Bank in accordance with the terms of an agreement with a donor."

and/or have no alternative source of capital that are seeking loans from the BWIs⁶⁹. When developing countries in such a dismal economic state negotiate with the BWIs, the relationship between the borrowing countries and the donors and management of the BWIs becomes even more sensitive.

The preceding discussion suggests that developing country members seem to be under more rigorous obligations under the BWIs⁷⁰. In other words, the BWIs seem to be able to have more influence on their developing country members through decisions and loans. The governance structure of the BWIs affects how these decisions and loan are made and, as a result, has ramifications on developing countries and their perception toward the BWIs themselves. The preceding paragraphs briefly touched upon the issue of governance structure by pointing out how the voting rules in which developed countries hold the majority of votes affect the ways in which these decisions and obligations are drawn up. The next section will continue to examine how the governance structure of the BWIs has brought out a sense of asymmetry from developing countries' perspective and, as a result, influenced the relationship between the BWIs and the developing countries.

2.2 Relationship with the developing country members

During the early days of the BWIs, the focus was on the war-torn countries of Western Europe. After the Marshall Plan took over the task of reconstruction in Western Europe, the World Bank first started to concentrate on making development project loans to the developing countries. In the meantime, while the focus of the IMF's operations

⁶⁹ After the debt crisis broke out in early 1980s, most of the developing countries, especially the low income countries were virtually cut off from the commercial loans by 1982 (Ghai, 1991). Similar situation can be observed when the financial crisis broke out in South-east and East Asia in 1997–98 when Thailand, Indonesia and South Korea had to seek emergency financial assistance from the IMF.

before 1971 was on developed countries, it found that it was losing influence over most of its developed member states after the collapse of the par value system in 1971 (Carreau, 1991). Consequently, the IMF gradually began to concentrate on its developing members after the 1970s. The relationship between the BWIs and the developing countries in the context of promoting the traditional model of “economic” development is the subject of Chapter 2.2.1.

In late 1980s and 1990s, there were changes in this traditional relationship on the World Bank’s part. As a response to the external pressures from the US Congress and environmental NGOs, the Bank has underwent some environmental reforms in the 1980s, which progressively led to the establishment of new mechanisms within the Bank in the 1990s. That brought a new dimension into the relationship with the developing members — a new relationship in which the Bank channels resources to assist developing countries implementing multilateral environmental agreements (MEAs). This development will be the subject of Chapter 2.2.2. As demonstrated in the following chapters, this closer link with the MEAs have, in turn, had impact on how the World Bank and the BWIs, as a group, have begun to employ their influence over developing countries to assist the implementation of a particular MEA: the FCCC.

2.2.1 Traditional relationship for development

After the collapse of the par value system in 1971, the IMF began its new role as a “development” institution. Virtually all of the new financing mechanisms (“facilities”) introduced after 1970, such as the 1974 EFF, 1976 Trust Fund, 1986 SAF and 1987

⁷⁰ Some commentators even suggest that: “While the IMF is able to exercise substantial control over the affairs of its poorer member states, it has very little control over the behavior of its richer member states.” (Bradlow and Grossman, 1995, p.420.)

ESAF, within the IMF had the common aim of better serving the needs of the IMF's developing country members (Carreau, 1991). In addition, references to developing countries were incorporated in the Second Amendment to the Articles of Agreement in 1978 as members deserving special consideration in some respects⁷¹. Although "development" was not added to the mandates of the IMF as prescribed in the Articles of Agreement, the purpose relating to trade (Article I[ii]), including that relating to the "development of productive resources" (Article I[ii]), should produce certain beneficial consequences without making "development" itself a purpose (Gold, 1981-82).

The IMF played another role different from that of a "development institution" in assisting its developing country members to tackle the debt crisis in the 1980s. This role continues to be quite significant in the latest crisis in Mexico, Indonesia and South Korea. This role of the IMF has wider implications beyond development, such as maintaining an orderly international financial order. Considering the fact that debt burden has always been a major obstacle for development in the highly indebted developing countries, this role still enables the IMF to play an important part in promoting development. Furthermore, the programmes attached to most of the IMF's facilities, in particular the EFF, SAF and ESAF usually prescribe conditions to be implemented that are for development purposes. As a result, the IMF, sometimes eagerly, sometimes hesitantly, has taken on the unfamiliar role of development lending by the end of 1980s (*The Economist*, October 1991).

In contrast to the IMF, the Articles of Agreement of the IBRD mandated the Bank to specifically "assist in the development"⁷² of territories of members". Nevertheless, the

⁷¹ Article V, Section 12(f)(ii) states: "Under the subsection (f)(ii) balance of payments assistance may be made available *on special terms to developing members in difficult circumstances ...*" (emphasis added.)

⁷² The term "development" was not defined in the Articles of Agreement of the IBRD. As the concept of "development" itself differs in a developing world where wide spectrum of developmental situations

Bank's earlier operation concentrated on the "reconstruction" side in re-building the war-torn Europe. It was not until the American Marshall Plan took over the reconstruction job in Western Europe (Kaplan, 1996) that the Bank began to turn its attention to its developing country members. During 1950s to 1970s, the World Bank's main operations were financing specific projects for development purposes, largely for infrastructure purposes such as dams and roads. By the 1970s, the Bank has come to regard itself as a major development institution responsible for promoting broadly based economic and social development in countries that were desperately poor and whose governmental policies were generating even further economic and social degradation (Mikesell and Williams, 1992). During the 1980s, in particular after the introduction of SALs and SECALs, the number of non-project loans increased rapidly. Although the World Bank provides only a small portion out of the total bilateral and multilateral financial resources for development purposes available for developing countries, the Bank is probably the single most important external source of ideas and advice to developing country policymakers (Gavin and Rodrik, 1995).

From the preceding discussion, it can be concluded that the BWIs have positioned themselves, intentionally (in the case of the Bank) or unexpectedly (in the case of the IMF), as the promoters of development in developing countries. In the late 1940s and throughout the 1950s and 1960s, "development" was referred to as economic growth, development of infrastructure and rapid industrialisation (Shihata, 1995, chapter 1). As a result, the BWIs began to promote development in their developing country members

exists, it is difficult to give a precise definition as to what "development" is. During the operations in the past five decades, the experience and thinking of the Bank about development have broadened with its membership over the years. For a more detailed discussion, see: Mason and Asher, 1973, chapter 14, and Shihata, 1995, chapter 1.



based on this model of “economic” development and to provide financial and technical assistance accordingly in the 1960s and 1970s.

In the 1980s, a new challenge to development arose from the serious disequilibrium in developing countries’ balance of payments, resulting from an increasing external debt burden and falling commodity prices (Shihata, 1995, chapter 1). The BWIs, thus, began to address this new challenge by introducing adjustment loans in order to assist developing countries to address the macroeconomic imbalances. The medicine prescribed by the BWIs to this new challenge, however, is still based on their traditional “development model”. The BWIs have been criticised for not taking into account the increasing social and environmental problems associated with this model in their developing country members (eg Cornia et al, 1987; Reed, 1992 and 1996). Meanwhile, the “medicine,” adjustment loans, with its programmatic nature and conditionality, has enabled the BWIs to gain more influence in their developing members⁷³.

Recalling the flexibility of the BWIs in introducing new reforms, as discussed in the preceding section, the BWIs have shown to be very adaptive in a changing socio-economic environment where the concept of “development” changed from time to time. As one commentator puts it “[the BWIs] have the institutional strength and flexibility to adapt their services to the new development concepts they have helped to promote and enjoy increasing international acceptance.” (Ardito-Barletta, N, 1994, p.199.) As these changes in the development paradigm and the operations of the BWIs took place, developing countries gradually became the only group of clients the BWIs are to serve in

⁷³ For more discussion on the leverages of structural adjustment lending of the BWIs over developing countries, see Chapter 3.2.1.

terms of lending operation after 1980 and the relationship between the BWIs and the developing countries began to attract more attention.

From the perspective of developing countries⁷⁴, their relationship with the BWIs has been anything but harmonious. There were more delegates from developing countries than from developed countries presented at the Bretton Woods Conference. However, the BWIs were mainly the joint design of the British and the American delegates. This led to “an almost inevitable lack of concern for the interests of developing countries” (South Commission, 1990, p. 27). In addition, it is noted by one commentator that: “Based on an informal arrangement, from which the [less developing countries] are excluded, the presidentship of the World Bank and the post of Managing Director of IMF are rotated between the US and Western Europe.” (Dasgupta, B, 1998, p. 73.) These historical events have left the impression that the BWIs were established to serve the developed country members’ interests.

In the mid 1970s, the developing countries, with their newly gained voting majority within the UN system, expressed their dissatisfaction of the existing international economic system, including the decision-making procedure within the system, by demanding for a New International Economic Order (NIEO)⁷⁵. For example, it was suggested that: “The participation of developing countries in the decision-making

⁷⁴ Among the group of “developing countries,” we have the “newly industrialised countries” in East Asia and Latin America, as well as less developed countries and high indebted countries in Africa. With varying degree of development, different countries will have different needs from and interaction with the BWIs. Nevertheless, the term “developing countries” is used loosely in this context referring to developing member states to which the BWIs lend exclusively after the 1980s. The same loose definition goes to “developed countries” discussed in the succeeding paragraphs, since developed countries have among them Nordic countries which are traditionally more sympathetic to the needs of developing countries as well as US which has doubts in the work and effectiveness of the BWIs. (As can be seen from the recent difficulties encountered by its President to request for extra funding for the IMF in the Congress.)

⁷⁵ The most important developments were the adoption of the two UN General Assembly Resolutions in 1974: the “Declaration on the Establishment of a New International Economic Order” (UNGA Res. A/3201[S-VI] of 1 May 1974) in May, and the “Charter of Economic Rights and Duties of States”(UNGA

process in the competent organs of international finance and development institutions should be adequately increased.” (UN General Assembly Resolution 3362 [S-VII] “Development and International Economic Co-operation”, 1975.) Meanwhile, developing countries also began to demand fundamental reforms in a decision-making process they perceived as asymmetry from within the BWIs⁷⁶. For example, the call for a change in the decision-making procedures within the BWIs has repeatedly come out from the Communiqué of G-24 of the IMF⁷⁷ since 1972⁷⁸. All of these demonstrate the dissatisfaction of the developing countries toward the governance structure of the BWIs.

Admittedly, at the time near the end of WW II, the Bretton Woods delegates, in particular the principle architect of the BWIs, the US and UK delegates, may not have been able to foresee how rapidly the colonial world would disintegrate and what this disintegration would do to the organisation of the IMF and the World Bank. Consequently, insofar as the Bretton Woods delegates were concerned, they saw no reason to distinguish those policies relating to trade, payments and capital flows which were considered to be favourable to the growth and prosperity of the developed countries from those favourable to developing countries (Mason and Asher, 1973). Despite this

Res. A/3281[XXIX] of 12 December 1974) in December. For a brief historical survey of the NIEO concept, see Van Dijk, 1987, pp. 91–98.

⁷⁶ For example, the Indian Governor made the following statement at the 1970 Annual Meeting: “In our judgment, the whole question of the structure of management, distribution of quotas, as well as of voting rights, needs to be examined afresh and thoroughly ... Whatever else this reform might encompass, it must clearly reduce the weightage of economic power and reflect instead the aspirations of the vast majority of the people in the world.” (Cited in Ferguson, 1988, p. 88.)

⁷⁷ G-24, the Intergovernmental Group of Twenty-Four on International Monetary Affairs, was set up in 1972. It represents the minority shareholders, both in terms of votes and the predominant numerical membership, in the IMF. It has evolved into a group that defends a common position for the Third World members of the IMF on international monetary issues (Ferguson, 1988, pp.74–75). It still holds regular meeting these days to provide advice and reports to the Boards of Governors of the BWIs on development issues.

⁷⁸ For example, in its First Ministerial Meeting in 1972, the G-24 “expressed its dissatisfaction that important decisions affecting the International Monetary System have been taken by a small number of developed countries to the exclusion and neglect of the interests of the rest of the international community, and that these decisions have adversely affected the economies of developing countries.” (Sauvant, 1981, p. 298.)

lack of foresight that failed to recognise the special need of developing countries in their original Articles of Agreements, the BWIs have been quick to identify the special circumstances of their developing country members. Consequently, they have adopted various mechanisms and decisions in the following five decades that seeks to better serve the interests of their developing country members⁷⁹.

However, one major element inherited in the operations of the BWIs has been at the root of the discontent of the developing members and that is, the governance structure of the BWIs. As noted in the preceding paragraphs, demand for reforming the decision-making process has been made since the 1970s and is continuing to be made in the 1990s⁸⁰. And yet no actions have been taken so far by the BWIs on this issue. The decision-making rules within the BWIs have given the developed countries greater influence in deciding the policies of the BWIs. Whereas basic votes are guaranteed to every member⁸¹, the proportion of basic votes to total votes has regressed every time when the capital (“quotas” in the IMF’s term) of the BWIs increased⁸². Various proposals have been put forward to reform this voting system regarded as asymmetry to developing countries^{83, 84}. The reform of the voting system requires a formal amendment to each of the Articles of Agreement of the BWIs. Nevertheless, the issue of voting system reform

⁷⁹ Another possible explanation for setting up these mechanisms specially for developing members, however, is that the BWIs had no other alternative as their developed members no longer use their financial services.

⁸⁰ For example, in the Report of the Commission on Global Governance published in 1995, it is stated that: “... the decision-making structures of the Bretton Woods institutions have to be reformed.” (Commission on Global Governance, 1995, p. 187.)

⁸¹ Article XII, Section 5(a) of the IMF Articles of Agreement: “Each member shall have 250 votes plus one additional vote for each part of its quota equivalent to 100,000 special drawing rights”. Article V, Section 3(a) of the IBRD Articles of Agreement: “Each member shall have two hundred fifty votes plus one additional vote for each share of stock held.”

⁸² For example, the proportion of basic votes to total votes in the IMF has been decreased from 12.5% in 1947 to 4.2% in 1992 (Gerster, 1993a).

⁸³ For example, the proportion of basic votes to total votes should be expanded; or the size of population should be considered (Gerster, 1993a).

⁸⁴ The voting formula in the IDA and the MIGA is much more favourable toward developing countries than the formula in the IMF and the IBRD. For detail discussion, see: Gianaris, 1990-91, p. 928.

was not taken up in two amendments (one in 1978 and one in 1993) to the Articles of Agreement of the IMF after 1972 when call for such reform was put forward.

The discontent the developing countries felt toward the operations of the BWIs has been derived from the imbalance in governance structure of the BWIs and the resulting asymmetric treatment received by the borrowing developing countries⁸⁵. The developing country members, as pointed out in the preceding section, are under more rigorous obligations, such as loans and arrangements as well as guidelines and decisions relating to loans, than developed country members. This, however, is not the consequence of treaty obligations in the Articles of Agreements. Rather, it is the result of a more frequent use of the BWIs' financial resources. Nevertheless, it can also be argued that the more frequent use the BWIs' resources by developing country members is the result of the asymmetric treatment implicit in the operations of the BWIs⁸⁶.

From the perspective of the Boards of Executive Directors, it may seem fair that developing countries should undertake a greater burden in the form of "loan obligations" and the applicable guidelines or decisions. However, by examining how these decisions and obligations are made, the decision-making process perceived as asymmetric by developing countries, seems to have partially produced a wider asymmetry in the operations of the BWIs. The Boards of Executive Directors are controlled by the

⁸⁵ According to Sir Joseph Gold, (Gold, 1980b) there are three types of classifications in the international monetary system: members that issues reserve currencies and members that issue other currencies; members in surplus and members in deficit in their balance of payments; and developed and developing members. One of the asymmetries in the international monetary system is that members with a surplus in their balance of payments are not required to take any adjustment measures; while members with deficit in their balance of payments bear the sole responsibility to adjust (South Commission, 1990).

⁸⁶ As some of the commentators argue, the international economic environment constructed by the BWIs has benefited only the developed world. In addition, development projects and programmes designed and financed by the BWIs to be applied on developing world failed to adopt input from the developing countries because of the asymmetric decision-making process. As a result, developing countries are "trapped" in poverty and debt and, consequently need to resort to the BWIs for assistance. See, for example, Bandow and Vasquez, 1992.

donors⁸⁷. The terms and conditions attached to the loans, arrangements in the IMF's case, have been criticised as being designed and drafted by the Bank's or the IMF's staff without sufficient consultation with the borrowing governments⁸⁸.

As a result, although the developing countries have greater access to the financial sources of the BWIs, they have less control over how the money is going to be used in their countries, as they need to implement conditionalities and policy advice drawn up by the staffs of the BWIs if the governments are to receive further financial assistance. Furthermore, while these decisions are made in a decision-making process where developing countries are not able to participate fully, the costs and consequences of the decisions and conditions made by the BWIs fall largely, if not exclusive, on the developing countries⁸⁹. In addition, the economic situation under which developing countries go to the BWIs for financial assistance is often in such a dire state that the borrowing governments have no other choice but to comply with the conditions set by the staffs of the BWIs⁹⁰.

The wider asymmetric treatment implied in the operations of the BWIs, thus, raises the following concerns. Firstly, the burden of obligations that developing countries need to carry under the BWIs; secondly, the ways in which decisions relating to lending

⁸⁷ For example, each of the five major donors have the right to point one Executive Director in both the institutions; while the developing countries have to form various "constituency" and elect one Executive Director among themselves in the same group. The five biggest donors have a total of 36.69% voting power in the IBRD and 38.82% voting power in the IMF in 1997.

⁸⁸ For example, the Letter of Intent, a document formally submitted by the government to the IMF to request for a stand-by arrangement, is "almost invariably drafted in Washington [by the staff of the IMF], with government left trying to negotiate variations in a draft presented to it." (Killick, 1995a, p. 155.)

⁸⁹ As one commentator puts it: "What is particularly unacceptable to developing countries ... is the inequality of a system where a few major contributing countries, which basically do not use the IMF's resources and are thus unaffected by its policies, are the ones that seek to impose, by way of their control of the policy-making process, their view of economic organization and management." (Ferguson, 1988, p. 230.) The same observation was made by Killick, but in the context of the BWIs, rather than developed countries and developing countries: "It is the [borrowing] governments which have to live, politically, with the consequences of SAP policies, whereas the BWIs are made largely immune from the adverse

operations are drawn up by the Executive Board; and thirdly, the unequal proportion of costs and consequences of decisions and programmes of the BWIs developing countries need to bear.

The decision-making process has contributed in producing this wider asymmetry treatment under the BWIs in the second and third aspects. Although the sense of asymmetry might not be shared by the developed countries⁹¹, the asymmetry, both in the governance structure and in the operations of the BWIs, is still perceived by developing countries under the operations of the BWIs. This perception of asymmetry has affected the relationship between the BWIs and the developing countries and, as the following chapter will seek to demonstrate, undermined the effectiveness of the legal and quasi-legal instruments the BWIs employed in their SAPs to influence the developing countries⁹². Further discussion will follow in future chapters.

The traditional model of “economic” development, encouraged and assisted by the BWIs with their adjustment programmes, has sometimes left out environmental considerations in the path of development and has resulted in the degradation of the environment, local and global⁹³. The coming of age of the concept of sustainable development reflects this inadequacy and has given rise to a new generation of MEAs that seek to redress this inadequacy by beginning to seek to regulate economic activities

consequences of bad lending decisions by a ‘preferred creditor’ status which largely ensures that they will get their money back for good and bad loans alike.” (Killick, March 1996, p. 217.)

⁹⁰ This is the reason the BWIs, in particular the IMF, are often called the “lenders of last resort”.

⁹¹ For example, developed countries might not regard the governance structure as asymmetrical since it is their taxpayers’ money that is being used and, as a consequence, they should be entitled to decide how the money should be spent. Nevertheless, this rationale might not be as convincing as developed countries would have liked for the following two considerations. First, it is the people in the borrowing developing countries that are greatly affected by decisions on how the money will be spent. Secondly, a large portion of the money disbursed by the BWIs often end up either back to the donor governments as, for example, repayment of official debt, or in the hands of their citizens in the form of, for example fees paid for foreign expertise and technology.

⁹² For further discussion, see Chapter 3.5.

⁹³ For more discussion on the structural adjustment programmes and the environment, see Chapter 5.3.1.

and development path of their parties⁹⁴. This has resulted in closer interaction between the World Bank and the MEAs, which brought out a new relationship between the World Bank and their developing country members after the late 1980s and throughout the 1990s, which we now examine.

2.2.2 *New developments in the 1990s*

The World Bank had an Office of Environmental and Science Affairs from as early as the 1970s⁹⁵. However, environmental consideration was not incorporated in the operations of the Bank loans. For example, the Bank, “recognising the urgent need of developing countries to develop their indigenous sources of energy”, was, in 1980, expanding its lending for coal and had established a lending programme in support of petroleum development (Broches, 1980) both of which had a potentially negative effect on climate change. It was not until the mid 1980s, when external criticisms from environmental NGOs and major donors, in particular the US Congress⁹⁶, had been mounting to such an extent, that serious reforms were undertaken within the World Bank. The Environmental Department was established in 1987 and various decisions were adopted regarding environmental aspects of the Bank’s lending operations in the late 1980s and early 1990s⁹⁷.

⁹⁴ For example, the Preamble of the FCCC states that: “... responses to climate change should be coordinated with social and *economic development* in an integrated manner ...” (emphasis added.)

⁹⁵ For this early environmental organisational reform within the World Bank, see: Le Prestre, 1989.

⁹⁶ Literature abound regarding the discussion of how these external pressures have helped to brought out reform in the World Bank. See, for example, Bowles and Kormos, 1995; Le Prestre, 1989, chapter 3; Mikesell and Williams, 1992, chapter 9; and, Rich, 1985 and 1994.

⁹⁷ For example, an Operational Manual Statement on the “environmental aspects of Bank work” was introduced in May 1984 (OMS 2.36); and an Operational Directive on the environmental assessment was adopted in October 1989 (OD 4.00). However, most of the major Operational Directives relevant to the environment only came in early 1990: such OD 4.01 (Environment Assessment) in October 1991, OD 4.02 (National Environmental Action Plans) in July 1992, and OD4.30 (Involuntary Resettlement) in June 1990. For more discussion, see: Shihata, 1994a and 1994b, Annex I, and 1995, chapter 17.

One of the earliest decisions, Operational Manual Statement (OMS) 2.36 on the Environmental Aspects of Bank Work, adopted in May 1984, specifically states that: "... the Bank will not finance projects that contravene any international environmental agreement to which the member country concerned is a party." (OMS 2.36, para. 9[e].) The statement was reiterated in the Bank's Operational Policy (OP) on Forest adopted in September 1993, which confirms that: "the Bank does not finance projects that contravene applicable international environmental agreements." (OP 4.36, para. 2⁹⁸.) No similar internal policy statement is found in the Bank in relation to other international public policy considerations such as human rights. Gradually, the Bank, from this passive obligation⁹⁹ of *not* financing certain types of projects, began to adopt a more active role in participating major MEAs, such as in the ozone regime. For example, at the end of 1980s, the Bank participated in the discussions leading to the establishment of the Multilateral Fund of the Montreal Protocol (Shihata, 1992).

The issues of financing mechanisms for the environment was raised during the 1989 Development Committee of the Boards of Governors of the IMF and of the World Bank. At this meeting, the Bank was requested to prepare a report assessing the requirements for additional funding associated with its increased attention to environmental issues and to prepare recommendations of possible mechanisms for managing such resources.

As previously indicated in the preceding section, the Bank has borrowed the legal concept of "trust funds" in its operations to take up new mandates without the need to

⁹⁸ The legal implications of these internal guidelines of the Bank on the interaction between the FCCC, an MEA, and the Bank will be subject to detail discussion in Chapter 5.2.2.

⁹⁹ The term "obligation" here is not in the sense of a strict "legal" obligation. In practice, there is no way to find out whether this "obligation" has been complied with by the Bank since there are no criteria to be used against which to judge the Bank's operations. The establishment of an Inspection Panel might

amend its Articles of Agreement. The Bank has been hosting more than 1,500 trust funds established by agreements between donors and the Bank (Shihata, 1994b), many for environmental purposes, where resources were mobilised from the donors.

The Bank has acted as trustee and implementing agency to administer their use (Shihata, 1995, chapter 17; Sand, 1995). As the demand for more resources for environmental purposes increased, the management of the Bank turned to the practice of hosting trust funds as a response. Among these trust funds, the most publicised was probably the GEF Trust Fund¹⁰⁰ established for the purpose of assisting its developing members to implement MEAs, the FCCC being one of which. According to its policy statement, the Bank is to identify and to address difficulties that prevent its developing members from participating in or properly implementing MEAs such as the FCCC (World Bank, 1997a). In addition to channelling financial resources to developing countries, the Bank also assists countries in complying with MEAs through its policy dialogue as well as in the design of economic and sector strategies and investment projects and programmes (World Bank, 1996a).

All these developments have brought about closer link between the World Bank and the MEAs. This closer relationship is reinforced by the tendency of the more recent MEAs that seek to regulate economic activities of the parties, over which the BWIs traditionally have competence, which is vividly illustrated in the case of climate change. It is set down in the FCCC that its parties are to: “cooperate to promote a supportive and open international economic system that would lead to sustainable economic growth and development in all parties ...” (FCCC, Article 3.5.) All parties to the FCCC shall “take

encourage the Bank to respect such “obligation.” Nevertheless, the decisions of the Panel are advisory in nature and the final decisions lie in the Executive Board. For more discussion, see Chapter 5.2.2.

¹⁰⁰ For more discussion on GEF, the GEF Trust Fund and the implications of the Bank serving as Trustee of the Trust Fund, see Chapter 4.1 and 4.2.

climate change considerations into account ... in their relevant social, *economic* and environmental policies and actions” (FCCC Article 4.1[f]) (emphasis added). With the unfolding of these developments, the Bank has grown from its role in project finance to, as one commentator puts it, “adjudicator and financier of domestic compliance with international environmental norms.” (Nelson, PJ, 1996, p.633.) Whether this shift has genuinely taken place is doubtful since the traditional role of the World Bank in development projects and programmes finance continues to take up a large part of the Bank’s portfolio. However, this new role has implications on the traditional operations of the Bank and the relationship between the Bank and its developing country members, which will be examined throughout the following chapters.

In May 1987, the World Bank President, at the time, Barber Conable stated that the Bank would address environmental aspects of development projects (Joannides, 1989). Since that time, the Bank has gone beyond addressing the environmental aspect of its traditional development projects and has established various mechanisms for the purpose of assisting its developing members to implement MEAs. This development has taken the relationship between the World Bank and their developing country members into a new dimension. The new relationship shows that the World Bank somehow needs to come to terms with the concept of sustainable development and recognises the need of its developing country members whose lack of resources have hampered their abilities to implement obligations under the MEAs to which they are parties. This new relationship also seeks to address some of the discontent of the developing countries as the new mechanisms have adopted novel governance structures¹⁰¹. Whether these new mechanisms have any impact on the relationship between the World Bank and its

¹⁰¹ For more discussion on the governance structure of these new mechanisms, see Chapter 4.1 and 4.2.

developing countries and enable the Bank to assist the implementation of the FCCC will be investigated in the succeeding chapters.

In this chapter, we recalled the flexibility of the BWIs at adapting themselves to changing external socio-economic environment and internal demand from member states. We have also examined the governance structure and the operations of the BWIs, which have been perceived by developing countries as asymmetrical in the context of heavier obligations for developing country members as well as the ways in which these obligations are drawn up and imposed through the existing mechanisms of the BWIs. After the emergence of sustainable development, overlap between the MEAs such as the FCCC and the operations of the BWIs has increased in areas of competence. The World Bank has established innovative mechanisms as a response and has assumed a new role in assisting the implementation of the MEAs in the developing countries. The BWIs employ both the existing and the innovative mechanisms to influence the developing countries, and legal and quasi-legal instruments are used in these mechanisms to enable the BWIs to play their roles more effectively. The next chapter will first examine the operations and effectiveness of the existing mechanism, the SAPs, of the BWIs and the implications of the relationship with the developing countries on these matters.

CHAPTER 3: STRUCTURAL ADJUSTMENT PROGRAMMES

This chapter will focus on the existing mechanism, the structural adjustment programmes (SAPs), that the BWIs employ to influence policy changes in developing countries. The SAP, with the application of its legal and quasi-legal instruments, has been an important part of the BWIs' operations in developing countries since the early 1980s. After a brief introduction on the concept of structural adjustment, this chapter will examine the operational and legal aspects of the structural adjustment lending, including its leverage over member states of the BWIs. Programme and policy-based lending and the application of conditionality are arguably the most powerful legal and quasi-legal instruments associated with the SAPs employed by the BWIs to influence policy changes in the developing countries and will be analysed respectively in more detail. However, these instruments have been subject to controversial debate and their effectiveness in influencing developing countries attracts no less attention. By drawing on the existing literature from the BWIs and other academic institutions evaluating the operations of the SAPs, this chapter will attempt to infer what makes the SAPs more effective at producing policy changes (an *outcome*) than achieving the desirable results (an *impact*) envisaged by the programmes. This chapter will conclude by looking at the implications the operations of the SAPs have on the relationship between the BWIs and their developing country members.

3.1 Structural adjustment: stabilisation and growth

Structural adjustment refers to a shift of the economic policies of a country in order to ameliorate specific economic difficulties, such as balance of payments problems¹. It is defined by the World Bank as “reforms of policies and institutions covering microeconomic, macroeconomic and institutional interventions; these changes are designed to improve resource allocation, increase economic efficiency, expand growth potential, and increase resilience to shocks.” (World Bank, 1990.)

The roots of the concept of structural adjustment are the global economic events of the 1970s (Reed, 1992). The sharp increase in petroleum prices in the 1970s brought huge export earnings for oil-exporting countries, most of which had deposited large sums of so-called “petrodollars” in private commercial banks. The sudden influx of cash compelled the private commercial banks to recycle “petrodollars”, which made external borrowing from private sources relatively easy and attractive² for developing countries in the 1970s. When the export earnings of most of the non-oil-exporting developing countries began to deteriorate because of the falling prices of primary commodities other than oil, commercial loans started to dry up (Kolko, 1988) and debt-servicing became more and more difficult to maintain. Under these circumstances, the debt crisis of the 1980s began when Mexico first announced, in 1982, that it would cease to pay its debt³.

¹ The process of adjustment actually involves two types of policy response. The first is “stabilisation”, which refers to the reductions of expenditures in order to bring about an orderly adjustment of domestic demand to the reduced level of external resources (the so-called “demand-side” management). The second is structural adjustment, which refers to changes in relative prices in order to make the economy more efficient and better able to use resources and thereby to engineer sustainable long-term growth (the so-called “supply-side” management) (World Bank, 1988a). However, since the discussion here is not economic-oriented, these two types of policies involved will be termed “structural adjustment” as a whole.

² Most of the financial resources from the IMF and the World Bank have a string of “conditions” attached to them. Compared with this conditionality requirement, borrowing from the commercial banks appeared to be more favourable than from the official sources.

³ Of course, several other factors attributed to the debt crisis in the 1980s, the detail of which will not be discussed here because they are not directly relevant to the thesis. For more discussion, see, for example, James, 1996.

The debt crisis of the developing countries in the 1980s exposed the structural weakness of the macroeconomic policies practised by these governments⁴, which could have had been reviewed and corrected earlier if the external financing from the private commercial banks had been more difficult⁵.

The efficient economy⁶ as developed by neo-classical economics is commonly referred to in most of the development literature as the theoretical model towards which a country should be adjusting. As mentioned earlier, structural adjustment refers to a change of economic policies of a nation, in particular macroeconomic policies. It is contemplated that developing countries, through structural adjustment policies, can stabilise their macroeconomies and repay their external debts in the short run and, eventually, achieve economic growth and development (Zarsky, 1994). Several macroeconomic policy instruments, mainly monetary, fiscal, exchange rate, trade and external debt policies (Davis, 1992), are used by most governments to achieve these objectives.

Adjustment measures can be implemented either on a government's own initiative or through structural adjustment lending from official financial institutions, such as the IMF and the World Bank. With a few exceptions⁷, most developing countries, in particular those burdened with external debt, implement the necessary adjustment

⁴ The need for adjustment stems from the unsustainability of a country's balance of payments, which might arise from external or internal sources (Please, 1987). The debt crisis is only one of the many factors affecting a country's balance of payments position.

⁵ In other words, most of the countries confronting a debt problem failed to adopt the required adjustment measures when they were incurring their debts in the 1970s (Please, 1987).

⁶ An efficient economy, according to Daly, involves three main policies: adjustment of prices to make them better measures of full social marginal opportunity costs, adjustment of macroeconomic conditions to achieve monetary stability, and, adjustment of national markets and prices to world markets and prices (Daly, 1992).

⁷ For example, the success of the four East Asian countries are achieved mainly through the unilateral adoption of most of the policy instruments deemed characteristic to the process of structural adjustment without the structural adjustment lending from official financial institutions. Taiwan, in particular, is an illustrative case in point since it is a member to neither the IMF nor the World Bank after 1980.

measures accompanied by structural adjustment lending from the IMF and the World Bank. One of the reasons was that, when the commercial loans from private banks were no longer available in early 1980s, the indebted governments had only the IMF and the World Bank to turn to for financial assistance, which were normally attached with adjustment measures. The following section will discuss the structural adjustment lending of the BWIs.

3.2 SAPs in the BWIs: operational and legal aspects

The concept of structural adjustment and structural adjustment programmes (SAPs) supported by the adjustment lending from the BWIs are different, but related, subject matters. Structural adjustment refers to the process of restructuring and reformulating a country's economic, mostly macroeconomic, situation. A SAP, on the other hand, is a set of policy reforms with certain objectives to be achieved within a limited period of time and usually refers to the type of programme accompanied by adjustment lending from the IMF and/or the World Bank. The borrowing government, upon the agreement of such adjustment loan, negotiates and concludes a SAP with the IMF and/or the World Bank, and implements various policies prescribed in the SAP. In order to focus on specific policy reforms aimed at structural adjustment, rather than on the theoretical discussion of the process of structural adjustment, this section and the present study concentrates on the SAP

3.2.1 Leverage over the member states

Structural adjustment lending was not introduced in either the IMF or the World Bank until the 1980s⁸. However, the increasing importance of this type of lending has been attested both by the amount of financial sources provided and by the number of countries involved. For example, in the World Bank group, Structural Adjustment Loans (SALs) and Sectoral Adjustment Loans (SECALs), as a share of total Bank lending, expanded to an average of 26% in 1989–95 (Jayarajah and Branson, 1995). The loan commitment of SALs and SECALs amounted to 39% of all the World Bank's commitments in FY 1998, despite some emergency assistance provided to East and South-east Asian countries (World Bank, 1998a). In the case of the IMF, cumulative commitments under all Structural Adjustment Facility (SAF)⁹ and Enhanced Structural Adjustment Facility (ESAF) arrangements approved since 1986 totalled SDR 9.9bn, and the cumulative SAF and ESAF disbursements amounted to SDR 8.1bn as of 30 April 1998. The IMF approved eight new ESAFs arrangements in 1997–98 totalling SDR 1.7bn. In 1997–98, the percentage of the SAFs/ESAFs commitments (less than 10%) and disbursements (less than 5%) in total resources provided by the IMF seems insignificant. Nevertheless, this was due to the unusually large amount of emergence assistance provided by the IMF to Thailand, Indonesia and South Korea. In fact, if the amount of resources provided to these three countries was deducted from the total amount of resources provided by the IMF, the percentage of ESAF commitments rises to 16% and

⁸ The first SAL of the World Bank was approved in 1980; the SAF and the ESAF of the IMF were established in March 1986 and December 1987 respectively.

⁹ SAF has been phased out in 1993. IMF Decision No. 10531-(93/70) SAF, 15 December 1993: "... from the date this decision becomes effective [the Fund] will no longer approve commitments to provide assistance from the SAF in conjunction with loans from the ESAF Trust." The last annual SAF Arrangement expired in December 1996.

the percentage of the SAF/ESAF disbursements jumps to 50% in total resources provided by the IMF (IMF, 1998a).

Not only has the structural adjustment lending become more important in the BWIs, it has also increased the leverage the BWIs have over their member states because of the following considerations. Firstly, after the two oil crises in the 1970s and the collapse of international commodity market in the 1980s, most of the developing countries, especially the low income countries encountering balance of payments problems and/or huge debt-servicing obligations were virtually cut off from the commercial loans by 1982 (Ghai, 1991). These events have put these developing countries in a situation where official loans from the IMF and the World Bank were the only alternatives left. Secondly, it is often argued that further loans from other sources are usually conditioned upon reaching an agreement with the IMF first¹⁰ (George, 1988). This “seal of approval” from the IMF indicates the importance of, in the eyes of the international commercial community, the policy advice given by the IMF and its purported effect on the macroeconomic situation of debtor countries¹¹. Thirdly, the IMF and the World Bank are able to gain access to the policy-making process, in particular economic policies, of the borrowing government through the negotiation of structural adjustment lending and the preparation of Policy Framework Papers (PFPs)^{12,13}. The IMF and the World Bank, through their influences over policymakers in the borrowing

¹⁰ However, the catalytic effect of the Fund in channelling the private lending has not been universally agreed upon. For example, Bird concluded in his empirical research that other factors, in addition to the IMF involvement, are at play in determining private lending (Bird, 1995).

¹¹ For example, a developing country is required to obtain a stand-by arrangement with the IMF before it is qualified for a debt rescheduling agreement under the Paris Club. For more discussion, see: Edward, 1984–85.

¹² The operations and implications of the Policy Framework Papers will be discussed in more detail in the succeeding section.

¹³ Some commentators even went further in commenting that, the recipients of the World Bank’s SAL had to “relinquish important parts of national sovereignty” in exchange for this huge and quick disbursing type of lending (Rich, 1994).

countries, also tried to generate profound changes in development policy and economic structure of the borrowing country (Reed, 1992). Fourthly, the ability to apply conditionality¹⁴ is another important tool for the BWIs to enjoy greater leverage over their developing country members. This tool is applied, for example, through the ways that a structural adjustment loan is disbursed. Adjustment lending, rather than a lump sum disbursement, is disbursed in several tranches. The release of each tranche of adjustment lending is contingent on fulfilment of the pre-agreed conditions. As a result, the borrowing government needs to show that efforts have been made in implementing the adjustment policies negotiated with the IMF and/or the World Bank in a timely manner if it is to receive the subsequent disbursement of the loan. It is, hence, fair to argue that the IMF and the World Bank can have immense leverage over the borrowing governments through the application of conditionality and that their respective management has used conditionality to advance the model of “development” perceived by the institutions as ideal.

3.2.2 *Operational aspects*

When structural balance of payments deficits¹⁵ resulting largely from the increase of oil price and the decline of export earning occurred in the mid and late 1970s, countries usually negotiated with the IMF for an Extended Fund Facility (EFF)¹⁶ first because the IMF was the principal international financial institution responsible to

¹⁴ More discussion on conditionality will follow in the succeeding section.

¹⁵ Structural balance of payments deficits refer to deficits that are not amenable to short-term financial measures (Mikesell and Williams, 1992).

¹⁶ The Extended Fund Facility was launched in 1975 in order to provide medium- to long-term assistance to developing countries. It was established to overcome structural balance of payments maladjustment with which the traditional one-year stand-by arrangement was inadequate to deal (Killick, 1995a; James, 1996).

correct its member's balance of payments position¹⁷. By the 1980s, faced with the debt crisis, and focusing particularly on the arrears problems of the heavily indebted poorest developing countries, the IMF recognised that the needed adjustments were of a more fundamental kind than it had confronted previously (Bretton Woods Commission, 1994). Thus, SAF was set up in March 1986 to provide highly concessional loans to low income developing countries facing protracted balance of payments problems; and the ESAF was set up in December 1987 to support especially vigorous adjustment programmes with a larger scale of resources and a longer repayment schedule (Schadler et al, 1993).

Meanwhile, in the late 1970s the World Bank realised that acceptable rate of development was constrained by a large balance of payments deficit and the effectiveness of its ongoing project lending was threatened by the deteriorating macroeconomic environment. It decided that, in order to fulfil its responsibilities, it had little choice but to provide its own resources to support programmes of structural adjustment (Reed, 1992; Williamson, 1982). As a result, SAL¹⁸ was set up in 1979 to stabilise a country's macroeconomic situation and to increase overall economic efficiency; and SECAL was set up in 1980 to expand the focus of adjustment from macroeconomic reforms to sectoral reforms (Reed, 1992). With the introduction of SAL

¹⁷ Article I of the Articles of Agreement of IMF states: "The purposes of the International Monetary Fund are [(vi)] to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members."

¹⁸ SAL is defined by the World Bank as: "non-project lending to support programs of policy and institutional change necessary to modify the structure of an economy so that it can maintain both its growth rate and the viability of its balance of payments in the medium term." (Jayarajah and Branson, 1995.)

and SECAL, the World Bank extended its main function of project lending¹⁹ into the area of programme lending²⁰.

With the introduction of respective adjustment lending in both institutions, the operations of the IMF and of the World Bank have become overlapped in certain aspect relating to structural adjustment. The IMF and the Bank had some early collaboration in the 1960s. However, the 1976 EFF introduced by the IMF and the 1979 SAL established by the Bank have moved these two organisations even closer (Gold, 1981-82)²¹. A SAP can be drawn up individually by the IMF or by the Bank. It goes without saying that different characteristics can be identified in the respective SAPs. For example, exchange and monetary policies are common elements in the IMF's SAPs, while budget and pricing policies are more often dealt with by the Bank's SAPs. However, with the increasing overlap in their respective operations and a closer collaboration between them, striking similarities can be found in the SAPs designed by the IMF or the Bank. For example, the following policy elements can be found in the majority of the SAPs designed by both: trade policy, sectoral policies, public sector enterprises, and policies relating to debt management (Feinberg, 1988, Table 1). A SAP might even be a joint product of the IMF and the Bank in some instances²².

¹⁹ Article III Section 4 of the Articles of Agreement of the IBRD lays down the conditions on which the Bank may guarantee or make loans. Section 4, paragraph (vii) states: "Loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development."

²⁰ As a matter of fact, the Bank had engaged in programme lending briefly in the 1960s and early 1970s (Mason and Asher, 1973). However, it is argued that there are some differences between the previous type of programme lending and the SAL (Williamson, 1982).

²¹ Literature abounds with regard to the relationship between the Bank and the Fund. See, for example, Gold, 1981-82; Feinberg, 1988. It has been widely perceived that the introduction of adjustment lending in the two organisations is the main driving force behind an ever closer relationship between the Fund and the Bank. However, since the present thesis does not look at the respective role of the Fund and the Bank, this section will only focus on the overlapping function in the operation of adjustment lending and SAPs, rather than on the wider implication on the relationship between the Fund and the Bank.

²² For example, when cross-conditionality is applied. For more discussion on conditionality, see Chapter 3.4.

The process of applying for a SAL from the Bank begins with the submission of a “Letter of Development Policies” by the member country, meaning that the borrowing government has to initiate the procedure for the loan²³. This Letter, which is similar to a Letter of Intent in the case of the IMF’s stand-by arrangement, describes the specific economic development programmes and policies the borrowing country will pursue, and is explicitly referred to in the loan agreement²⁴. This Letter of Development Policies, requesting a SAL, has to be scrutinised by the Bank and given a response by the Executive Directors. The approval of the request and the granting of a loan take the form of a loan agreement. This loan agreement with the borrowing member is an international agreement, a “treaty” in the broad sense, governed by international law and is registered with the UN as such (Broches, 1959).

The application of an SAF/ESAF²⁵ from the IMF begins with the submission of a “Memorandum of Economic Policies” (MoEP), which is similar to a Letter of Intent, by the borrowing government. The government needs to outline the medium-term macroeconomic and structural adjustment programme and policies to be followed to achieve the objectives of the programme. In the case of ESAF, the borrowing government needs to prepare, in consultation with the staffs of the Bank and the IMF, a Policy Framework Paper (PFP), before it submits its MoEP. The policies and measures contained in the MoEP are usually similar to those prescribed in the PFP. The IMF’s

²³ Paragraph 12 of Bank’s OP 7.01 of July 1994 on Contractual Agreement describes the Letter of Development or Sectoral Policy as setting out “the most salient elements of the proposed adjustment programme and the borrower’s commitment to carry out the programme”.

²⁴ The fact that this Letter of Development Policies is referred to in loan agreement has its legal implication (Kremmydas, 1989), as shall be discussed later.

²⁵ The application procedures and the required documents for a SAF are slightly different from those for an ESAF because of different operational procedures. For example, resources committed under the SAF and ESAF are both made available in the form of loans under three annual arrangements approved by the Fund. However, in the case of the SAF, one disbursement is made for each annual arrangement while in the case of the ESAF, disbursement is divided into two instalments under each annual arrangement. Nevertheless, the operations prescribed here are applicable to both.

Board of Executive Directors will then review and discuss the MoEP submitted by the government before it makes its decision on whether to grant an SAF/ESAF arrangement to the member. In contrast to the practice of stand-by arrangements, there is a SAF or ESAF loan agreement between the Fund and the borrowing government. Nevertheless, this form of loan agreement resembles a stand-by arrangement in various ways, in particular with regard to the legal consequences of failure to observe performance criteria or a member's other departures from its programme²⁶.

The PFP is another important operational aspect of a SAP. The IMF requires that member applying for an ESAF prepares a PFP describing the member's medium-term objectives and the main outlines of the policies to be followed in pursuing these objectives. Although the scheme was not initiated until the introduction of the ESAF in 1987, the PFP has become an essential instrument in the SAP and, in particular, an important device for ensuring effective co-ordination and consistency between the policy advice given by the IMF and by the World Bank (Jayarajah and Branson, 1995). The PFP is drawn up in a collaborative effort by the borrowing government, the IMF and the World Bank, sets out the medium-term macroeconomic and microeconomic objectives, and identifies policies and measures for achieving these objectives. The IMF staff are responsible for the macroeconomic projections and policy design, while the World Bank staff provide complementary support for sector and sub-sector policies (Jayarajah and Branson, 1995). The PFPs are discussed but not voted upon by a committee of the Bank's Board of Executive Directors, whose comments are then "taken into account"

²⁶ According to Gold, question has never been raised regarding whether failure to observe performance criteria or other departures from a programme supported by the IMF under the SAF or the ESAF could be regarded legally as breaches of contract. In practice, though, it is suggested that, if such questions were raised, the IMF would come to a conclusion that such events, i.e. failure to observe performance criteria or other departures from a programme supported under the SAF or the ESAF, might not be considered as breaches of contract. (Gold, 1996)

when the IMF's Board of Executive Directors is presented with the paper (Feinberg, 1988)²⁷. The PFPs serve some meaningful functions such as reducing the risk of conflicting advice from the Bank and the IMF, and streamlining the negotiation process between the borrowing government and the BWIs. However, a potential problem is that it may reduce a country's policy-making options (Bradlow and Crossman, 1995). This, in turn, helps to give the BWIs an even greater tool to influence the borrowing governments by limiting the policy options available to them once they decided to make use of adjustment lending.

As we can see, a SAP associated with either the SAL/SECAL from the Bank or SAF/ESAF from the IMF contains economic policy suggestions for the borrowing government. There are various instruments, legal or quasi-legal associated with a SAP. Whether the borrowing government is required²⁸, legally or in practice, to carry out the specific economic policies in a SAP depends on the legal characteristics of these various instruments, to which policy recommendations are attached. The following section will examine the legal characteristics of these instruments.

3.2.3 Legal aspects (legal and quasi-legal instruments applied)

Various documents are prepared either by the borrowing government or by the BWIs' staff in negotiating a structural adjustment lending from either the Bank or the IMF. Table 3-1 puts together all the relevant instruments in a descending order in terms

²⁷ According to the Bank's BP 2.20 of January 1997 on PFP, "PFPs are circulated to the Board for information only" and the IMF Board discusses the PFPs a week later after the Bank Board has its discussion (BP 2.20, para. 9).

²⁸ The legal character of the specific economics policies in a SAP will determine the legal consequences of the borrowing government when it fails to observe these policies. This, in turn, can have implications to the effectiveness of the SAP at influencing the borrowing developing countries. More discussion on the effectiveness of the SAPs and relevant issues will follow.

of the legal effect of these instruments, followed by more discussion on the legal characteristics of these instrument.

Table 3-1: Structural adjustment instruments (SA instruments)

Legal effect	Instruments used in structural adjustment lending
Legally binding international agreement	Loan agreement between the World Bank and the borrowing government on a SAL/SECAL.
	Letter of Development Policies submitted by the borrowing government in applying for a World Bank SAL/SECAL.
Non-binding, but usually carry practical implications in the case of failure to comply ²⁹	Memorandum of Economic Policies submitted by the borrowing government in applying for an IMF SAF/ESAF, in particular for an ESAF ³⁰ .
	Policy Framework Paper prepared by the borrowing government, in consultation with the staff of the World Bank and the IMF, prior to the application of an IMF ESAF ³¹ .
Non-legal, indirect influence	Debt rescheduling under the Paris Club in certain cases will only be undertaken on the basis of an IMF SAF arrangement between the debtor country and the IMF (IMF, June 1997, p. 345).
	The “seal of approval” effect ³² of an IMF arrangement in influencing a government’s credit ranking internationally (applicable to all the IMF arrangements, including the stand-by and other facilities).

The loan agreement between the Bank and the borrowing government for either a SAL or a SECAL is regarded as a binding international treaty (Head, 1996). In the case of the Letter of Development Polices, the described measures in this document are heavily negotiated between the Bank and the borrowing government in the majority of

²⁹ For example, failure to comply might interrupt the disbursement of the subsequent tranche of money.
³⁰ The disbursement of an annual ESAF is divided into two tranches. The disbursement of the second tranche will depend on whether the performance criteria prescribed in the MoEP have been observed.
³¹ The measures and policies prescribed in the PFP are usually incorporated later in the MoEP submitted for requesting an ESAF.
³² The “seal of approval” effect refers to the practice in which other external financing to a country is dependent upon reaching a prior agreement with the IMF.

the cases, even though the Letter is later submitted by the borrowing government as its unilateral intent to implement these measures. Some commentators have argued that “the Letter of Development Policies constitutes a unilateral declaration of intent with a binding or quasi-binding character” on the ground that, by submitting a request for a SAL, the government indicates an intention to be bound since the request leads to the approval of the loan agreement regarded as a contractual agreement (Kremmydas, 1989)³³. In the Bank’s OP 7.01 on Contractual Agreement, the Letter of Development Policies and the borrower’s commitments “are incorporated by reference in the Loan Agreement, which also includes an event of suspension that allows the Bank to suspend disbursements if a situation arises that makes it ‘improbable that the Programme [ie the contents of the Letter], or a significant part thereof, will be carried out’.” (OP 7.01, para. 12.) This means that the Letter of Development Policies, and the economic measures and policies presented in it, are part and parcel of the Loan Agreement, which is itself a binding international legal agreement on both the World Bank and the borrowing government. As a result, the Letter and the economic policies prescribed in it, have a binding effect on the borrowing government.

In the case of the IMF’s SAF/ESAF³⁴, the MoEP is, as in the case of the Letter of Intent, considered to be the document of the government³⁵. According to Sir Joseph Gold,

³³ Under this line of reasoning, the Letter of Development Policies is to be regarded as an offer, while the approval by the Executive Directors of the Bank constitutes an acceptance. However, an offer does not automatically become binding before an actual contract is concluded. For example, the offer, ie the Letter of Development Policies, can be rejected by the offeree (the Bank’s Executive Directors), or it might receive a counter-offer, ie some amendments proposed by the Executive Directors. Under all these circumstances, a contract, ie the SAL agreement, breaks down. As a result, it seems futile to argue the legality of the Letter of Development Policies on the ground of this unilateral intention since it might lead to nowhere when the negotiation breaks down.

³⁴ Most of the information regarding the operational and legal aspects of the Fund’s SAF/ESAF has been obtained through interview with a staff member from the legal department of the IMF.

³⁵ The operations of the SAF/ESAF have lots of similarities with those of a stand-by arrangement. The only distinctive difference is that currency swap is not practised in the case of an SAF/ESAF since

that Letter is not regarded as having binding effect (Gold, 1970). By the same token, the MoEP is not considered as a binding document on the borrowing government. As a result, policies and measures prescribed in the MoEP do not seem to bind the borrowing government. However, non-observance with the performance criteria³⁶ set down in the Letter of Intent can result in the delay or cancellation of the disbursement of the subsequent tranche³⁷. Since the resources committed under a SAF or an ESAF take the form of three annual arrangements, non-observance of conditions sets down in the MoEP will delay or affect the IMF's decision on the second or third annual arrangement. Consequently, although the government is not bound in a strictly legal sense to follow the policies and measures set down in the MoEP, in practice, however, these policies and measures carry certain weight in the sense that failure to comply can interrupt the disbursement of the subsequent tranche.

As for the legal character of another important instrument, the PFP, it is the document of the borrowing government and does not have the same legal effect as, for example, a SAL agreement between the Bank and the borrowing government. A PFP is a statement by the borrowing government which sets out "its medium-term objectives, policies, strategies, and plans on economic development adjustment, and the related financing requirements for the next three years" (BP 2.20 of January 1997 on PFP, para. 1). It is a unilateral declaration on the part of the borrowing government, even though it has been discussed and negotiated extensively with IMF and Bank staff. It does not have

resources committed under the SAF/ESAF take the form of a loan that is disbursed and repaid in a freely usable currency or US dollars.

³⁶ Performance criteria are "certain policies, targets, or intentions which a member states that it will observe and on the observance of which the member's right to purchase has been made to depend" (Gold, 1970, p. 140). Performance criteria are usually, but not restricted to, quantitative conditions such as the exchange rate or interests rate.

³⁷ Nevertheless, in the IMF's practice of its stand-by arrangement, a new agreement is generally hammered out and IMF assistance continues when performance criteria and ratios cannot be met. The practice of

the same legal character as that of a World Bank loan in the sense that failure to comply with the latter will entail legal consequences. As a result, failure to reach a specific objective or policy prescribed in a PFP does not necessarily have immediate legal consequence such as the suspension of the ESAF arrangement. However, to the extent that the PFP is a prerequisite of applying for an ESAF arrangement, the policies set out in the MoEP are usually those prescribed in the PFP, and it involves all parties, ie the borrowing government, the IMF and the Bank, in the process of drafting, it evokes a sense of responsibility on the part of the borrowing government to take into consideration any policies, strategies and plans prescribed in the PFP.

Another aspect not directly related to the legal characteristics of various SA instruments, but no less important is the informal and indirect influence of the BWIs on a country's ability to attract other external financing³⁸. The conclusion of an agreement, usually with the IMF, can provide assurance for other lenders that the country concerned has "formulated a program that the IMF considers satisfactory enough to justify support with its resources" (Gold, 1982, p. 10)³⁹. In addition, as pointed out previously, a debtor country is usually required to reach an arrangement with the IMF and/or the Bank if a debt-rescheduling agreement with the Paris Club is to be agreed upon. With the indirect influence of the BWIs' adjustment lending in mind, governments, in particular poor and indebted developing countries, are usually under great pressures to reach an arrangement

either waiving or revising performance criteria has indeed become a wide-spread feature of Fund flexibility in its stand-by arrangement (Pirzio-Biroli, 1983).

³⁸ This informal and indirect influence is not an exclusive feature of structural adjustment lending. It applies to the normal stand-by arrangement from the Fund.

³⁹ This observation is made in the context of the stand-by arrangement of the Fund. Nevertheless, considering the equally important implications of a SAF/ESAF arrangement on a country's economic state, the same observation seems applicable in the context of structural adjustment operation as well.

with the BWIs for such an arrangement may serve to generate more resources from other sources (Feinberg, 1988)⁴⁰.

As the preceding discussion shows, the legal effect of various instruments associated with structural adjustment lending differs. More salient legal character, such as a legally binding loan agreement, is usually associated with the Bank. Both the IMF and the Bank have legal duties to protect the interests of the member states by way of properly safeguarding their assets, which, in turn, can make sure that every member will have a pool of resources to draw from whenever needed⁴¹. In determining the legal character of any of their mechanisms, the BWIs, in addition to the consideration of properly safeguarding their resources, must also take into account the following factor. In cases such as adjustment lending and SAPs where a country's economy is under scrutiny and its population will be affected, the BWIs need to be very sensitive in deciding whether a strictly binding legal document is desirable, in particular where policy advice will be given to the borrowing government. As a result, not all of the SA instruments are legal documents with binding effect. Recalling the discussion in Chapter 2 on the history and operations of the BWIs, this pragmatic attitude toward the legal character of various SA instruments illustrates once again the flexibility of the BWIs in their operations. Nevertheless, the flexibility in their structural adjustment-related operation does not diminish the leverage the BWIs can have over the developing countries. Through the

⁴⁰ Literature abounds regarding this indirect influence of the BWIs in attracting other external finance for the borrowing countries, in particular in the context of the IMF stand-by arrangement. See, for example, Gold, 1980a and 1982; and, Edward, 1984-85. Although most the analysis focuses on the stand-by arrangement, similar influence can certainly be extended to other IMF assistance, such as the SAF/ESAF where an even larger-scale economic restructure takes place.

⁴¹ In the case of the IMF, one of the purposes of the IMF is "to give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards" (IMF Articles of Agreement, Article I para. [v]). In the case of the Bank, when making a loan to any member, for example, the Bank is under an obligation to secure a full guarantee of the repayment of the principal and the payment of interests and charges on the loan from the borrowing government (IBRD Articles of Agreement, Article III Section 4[I].)

negotiation and involvement of almost all SA instruments, the BWIs have gained considerable access to the decision-making process of the borrowing government. In fact, regardless of the legal characteristics of these SA instruments⁴², the BWIs possess a considerable degree of influence on their developing country members through the application of conditionality and programme and policy-based lending, which we will now turn to.

3.3 Programme and policy-based lending

There is no universal definition on what a programme, or policy-based, lending is. Professor Mosley, et al, defined the term as follows: “Programme lending divorces development finance from specific items of investment; it is given as general support for a deficit balance of payments to facilitate imports that should increase economic growth and, hopefully, development.” (Mosley, Harrigan, and Toye, 1996a, p. 27.) Another definition is given by Mason, et al: “... the only term that could pretend to encompass this variety [of all the loans and credits committed by the Bank and the IDA that have been called programme loans] is the negative one: ‘non-project’.” (Mason and Asher, 1973, p. 290.) Table 3-2 highlights some of the differences between a project and a programme and/or policy-based lending.

⁴² Considering this degree of influence where developing countries’ interests are greatly at stake, the operations of the BWIs in the process of negotiating, drafting and granting a loan should proceed in such a way that allows participation to the greatest possible extent from the borrowing developing countries. Nevertheless, the governance structure of the BWIs is not exactly designed to allow such participation. For example, in the Executive Board where the decision of loan is made, the five biggest donors hold more than one-third of votes among themselves and have the ability to veto decisions relating to a particular loan. More discussion on the implications of the governance structure on the implementation of SAPs by the borrowing developing countries will follow in Chapter 3.5.

Table 3-2: Differences between project and programme and policy lending

	Project lending	Programme and policy lending
What the loan supports	Specific projects (eg dam, road).	General policy reform (eg correction of macroeconomic policies).
How the money is spent	Mostly specified in the loan.	Left at the discretion of the borrowing government.
The expected results of the loan	A completed project that is fully operational.	A change of economic environment conducive to growth

As Table 3-2 illustrates, the essence of a programme and policy-based loan is to seek a change of policies in the borrowing government. The “policy intent” is what distinguishes a programme lending from a project lending. A project loan does not concern the policy framework in which the project, or the borrowing government, operates. Programme and policy-based lending, on the other hand, encourages the borrower to conduct a thorough examination of its policy framework in which the government operates. The programme accompanying such policy-based lending then offers advice on the kind of transformation that will be required to change this policy framework.

As laid down in its Articles of Agreement, the IMF financing has always been of a policy-based nature for it does not finance any specific project or item of investment⁴³. The World Bank, on the other hand, can only, in principle, make loans to its members “for the purposes of specific projects of reconstruction or development” (IBRD Articles

⁴³ One of the purposes of the IMF, as laid down in Article I(v) of the IMF Articles of Agreement, is to “give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus *providing them with opportunity to correct maladjustments in their*

of Agreement, Article III, Section 4[vii]). Only in “special circumstances” can the Bank engage in non-project lending. Prior to the 1980s, the division of labour between the IMF and the World Bank was clear in terms of the type of finance each was engaging in⁴⁴. However, since the introduction of adjustment lending in both of the BWIs after the 1980s⁴⁵, both began to engage in this type of “non-project” lending. The purpose of programme lending is to improve the borrowing country’s balance of payments situation by supporting changes in such things as government spending, services, borrowing and subsidies (Head, 1991). To the extent that programme dollars are worth more to a borrowing country than project dollars⁴⁶, programme loans can offer the possibility of increased leverage for the BWIs. In addition, the balance of payments support given in the programme loan directly affects the macroeconomic policy choices open to the borrowing country (Mason and Asher, 1973).

Recalling Table 3-1, most of the instruments applied in structural adjustment lending represent classic examples of how the BWIs are able to gain access to the policy-making process of the borrowing governments through their programme loans such as the Bank’s SAL/SECAL and the IMF’s SAF/ESAF. For example, the PFP, prepared by the borrowing government in consultation with the staffs of the Bank and the IMF, needs to set out the medium-term objectives and the outlines of the policies to be followed in achieving these objectives. Since the purposes of an adjustment-type loan is restructuring and reformulating a country’s economic, mostly macroeconomic, situation, the process

balance of payments without resorting to measures destructive of national or international prosperity.” (emphasis added.)

⁴⁴ The Bank has had some limited experiences with programme lending in the 1950s. For further discussion, see Mason and Asher, 1973, chapter 9.

⁴⁵ For more discussion on the introduction of adjustment lending in both of the BWIs, see Chapter 3.1.2.

⁴⁶ Since it is more difficult to dictate how the money should be spent in a policy-based loan, the borrower might find the dollars borrowed from a programme loan more desirable than from a project loan.

of joint drafting the PFP gives the BWIs the opportunities to influence the borrowing country's choice of economic and other development policies.

Policy-based lending has had its problems, however. From the perspective of the borrowing countries, it is often difficult to agree to wide-ranging policy conditions as part of a lending programme, even when the government may perceive many of these policies as beneficial. From the perspective of the donor countries, they have been subjected to growing pressure to add new policy objectives that such lending must achieve whenever a new fad emerged (Singh, 1995). Nevertheless, these problems do not diminish the importance of the policy-based structural adjustment lending of the BWIs, to which many developing countries still turn to as a last resort in the attempt to solve their long-term, structural balance of payments difficulties. As a matter of fact, in combination with the special tranching policies of the BWIs' adjustment lending⁴⁷, programme and policy-based lending has served as a useful tool to increase the influence of the BWIs over the borrowing developing countries.

3.4 Conditionality

The application of conditionality is closely associated with programme and policy-based lending. When funding agencies and/or donors wish to promote policy reform, conditionality is their most coercive tool. Conditionality has been defined by some commentators as "the exchange of financial assistance for policy reform" (Fairman, and Ross, 1996). Both programme and policy-based lending and the application of conditionality seek a change of behaviour in the borrowing governments and give leverage to the BWIs in influencing their developing country members.

⁴⁷ The tranching policy and its implication will be discussed in the section on conditionality (Chapter 3.4).

The issue of conditionality has generated most debates in the experiences of the SAPs. Conditionality, in the context of the IMF operations, refers to “the principle ... that IMF resources are not automatically available to member countries, but instead are available only in cases where the member agrees to follow IMF-approved policies that are intended to help the member overcome balance-of-payments difficulties.” (Zamora, and Brand, 1990, p.391.⁴⁸) The use of the IMF’s resources is temporary in nature and should be subjected to certain policies and programmes adopted by the IMF⁴⁹. Conditionality refers to the pragmatic and flexible body of these policies and programmes and is used to govern the use of the IMF’s resources in a manner consistent with the Articles of Agreement (Guitian, 1981). Conditionality in the context of the IMF is, hence, not limited to the operations of the SAF/ESAF⁵⁰. The World Bank, on the other hand, employs conditionality as an important instrument to improve both the design and the effectiveness of its adjustment programmes (Reed, 1992). The SALs and SECALs are usually disbursed in several tranches. The borrowing government needs to comply with certain pre-agreed policy targets in order to receive the subsequent tranche. The discussion of conditionality relating to the World Bank lending is, therefore, most relevant to the implementation phase of SAL/SECAL (Jayarajah and Branson, 1995).

Traditionally, IMF conditionality is distinguished from World Bank conditionality. The IMF draws up demand-side conditionality while the World Bank

⁴⁸ The “Guidelines on Conditionality” was adopted by the IMF Executive Board (Decision No. 6056-[79/38]) on 2 March 1979.

⁴⁹ Article V Section 3 prescribe the conditions governing the use of the Fund’s general resources; and para. (a) states: “The Fund *shall adopt policies on the use of its general resources ... in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund.*” (emphasis added.)

⁵⁰ The IMF Board’s decision of the Guidelines on Conditionality provides guidelines in the use of Fund’s general resources and stand-by arrangement. These guidelines are applicable in the operations of the ESAF because of the requirement that: “... the Fund in administering the [ESAF] Trust shall apply the same rules as apply to the operation of the General Resources Account of the Fund.” (Section VII, para. 1[b],

focuses on supply-side conditionality⁵¹. However, it is difficult to distinguish between demand and supply measures. Similarly, there has been an increasing overlap between the roles of the IMF and of the World Bank during the past two decades, in particular regarding the operations of the SAPs. Consequently, the line between this categorisation has blurred gradually. For example, it has been recognised within the IMF that the policy coverage of programmes should be broadened to include more supply-side measures (Killick, 1995a). Thus, instead of dwelling upon such categorisation, the discussion here will refer to all types of conditionalities, be they designed by the IMF or the Bank⁵².

In addition, another type of conditionality known as “cross conditionality” refers to a situation in which an SAL will not be approved by the Bank unless an agreement with the IMF on adhering to IMF conditionality is reached⁵³ (Mukherjee, 1994) or vice versa. This form of conditionality has attracted no less attention⁵⁴. There are various definitions and forms of cross-conditionality. The type used between the Bank and the IMF themselves, referring to a situation where the approval of the Bank’s SAL is conditioned upon the approval of an IMF arrangement, or vice versa, is probably the most controversial. The Bank and the IMF themselves claim to have avoided cross-conditionality in the narrow, legalistic sense of exercising vetoes or requiring formal concurrence on each other’s loans (Feinberg, 1988). The IMF, for example, has a strict

Instrument to Establish the Enhanced Structural Adjustment Facility Trust, Decision No. 10530-[93/170] ESAF, December 15, 1993.) (IMF, June 1997, p. 40.)

⁵¹ Demand-side policies seek to control total demand by using economic policies, primarily monetary and fiscal. Supply-side policies aim to achieve efficiency through economic policies and measures designed to stimulate production by relying heavily on the direct use of incentives (Shim, and Siegel, 1995).

⁵² For more discussion on the differences of the types and operations of conditionality between the IMF and the Bank, see Mosley, Harrigan, and Teye, 1996a, pp. 65-67.

⁵³ It is not a legal requirement for a government to have a prior arrangement with the Fund before it can apply for a SAL to the Bank. However, this “cross conditionality” exists in certain SAPs since adhering to a Fund programme is often an indication for the Bank that this government has begun to implement certain necessary adjustment policies.

⁵⁴ Literature abounds regarding the practice of the various form of cross-conditionality in the BWIs. See, for example, Feinberg, 1988, pp. 552-56; Gold, 1982, pp. 16-17; and, Kremmydas, 1989.

definition of cross-conditionality and has stressed that “Cooperation [with the Bank] is of the essence, but it will be conducted *in a manner that will not give rise to cross conditionality.*” (emphasis added) (IMF, June 1997, p. 339.)⁵⁵ However, as the IMF and the Bank have worked harder to define a joint package of policy advice and with the introduction of the ESAF within the IMF, cross-conditionality is transformed from an informal or indirect form to a more explicit linkage between the IMF stand-by and the Bank policy-based operations⁵⁶ (Mosley, Harrigan, and Toye, 1996a). Under such circumstances, the borrowing government needs to negotiate with the IMF and Bank almost simultaneously for a set of policies satisfactory to both. This phenomenon serves to further increase the leverage of the BWIs over the borrowing developing country members.

In terms of the legal implication of conditionality, failure to comply with conditionality often bears the consequence of being unable to receive the release of the subsequent tranche. In the case of the ESAF, failure to comply with conditions can result in the suspension of the disbursement of the second instalment in an annual arrangement⁵⁷. In the case of World Bank SAL/SECAL, the typical loan is disbursed in two tranches, and disbursements depend on satisfactory compliance with some essential conditions and with the implementation of the programme in general (World Bank, 1988a). In addition, albeit not a legal requirement, poor implementation of conditionality

⁵⁵ This remark was made at the Chairman’s summary of the discussion on special disbursement account at an Executive Board Meeting on 26 March 1986, and in the context of PFP and the SAF.

⁵⁶ For example, up until 1989, not one of the Bank’s SAL was agreed without an IMF stand-by arrangement already being in place (Mosley, Harrigan, and Toye, 1996a).

⁵⁷ In the IMF’s “Instruments to Establish the Enhanced Structural Adjustment Facility Trust”, it is stated specifically that: “Disbursements under each annual arrangement shall be made in two instalments, the first after approval of the corresponding arrangement, and *the second after the conditions established under the arrangement for that disbursement have been met.*” (emphasis added.) (IMF, June 1997, p. 30.)

has often resulted in the country being unable to obtain another fresh loan until there has been a clear shift in attitude toward adjustment (Webb, and Shariff, 1992).

As illustrated, failure to comply with conditionality does have its legal consequences⁵⁸ in either the IMF's SAF/ESAF or the Bank's SAL/SECAL, the most important one being the cancellation of the disbursement of the subsequent tranche of money. In practice, however, failure to comply does not necessarily trigger this legal consequence immediately. For example, in the World Bank's 1988 evaluation on its adjustment lending, "... almost all tranches have eventually been released, even though almost all tranches are experiencing tranches release delays as a result of insufficient progress in fulfilling conditions" (World Bank, 1988b, p. 7). Nevertheless, this does not mean that conditionality has no influence on the borrowing government at all. Although cancellation rarely happens in either the Bank's or the IMF's case, failure to observe the conditions causes a delay in the subsequent disbursement. In addition, the government usually needs to undertake another round of negotiations with either the Bank or the IMF, or both, in cases when conditions are not met in order to receive the subsequent disbursement. This fresh round of negotiation often means new set of conditionalities. For example, in cases where conditions for the second disbursement in an annual ESAF arrangement are not met, the borrowing government will be unable to receive the subsequent disbursement unless "consultation has taken place between the Trustee [IMF] and the member [borrowing government] and understandings have been reached regarding the circumstances in which the member may request the disbursement of that instalment." (Instrument to Establish the Enhanced Structural Adjustment Facility Trust,

⁵⁸ The legal consequences are derived from the following. In the case of the Bank, it is derived from the loan agreements between the Bank and the borrowing government. In the case of the IMF, it is derived from the decisions of the Board of Executive Directors regarding the establishment of the ESAF Trust.

Section II para. 3[b], Decision No. 10530-[93/170] ESAF, December 15, 1993) (IMF, June 1997, p.30.)

In addition to the conditions regarding the tranching policies of the adjustment lending, the BWIs can also set down pre-conditions for the government to implement before an adjustment lending is approved. In the case of the IMF, its Guidelines on Conditionality states that, “A member may be expected to adopt some corrective measures *before* a stand-by arrangement is approved by the IMF ...” (para. 7) (emphasis added). In the case of the World Bank, “the front-loading of conditionality, ie the requirement that key conditions are fulfilled in advance of the release of any part of the loan” has been identified as some of the trends developing in the Bank’s adjustment lending in the second half of the 1980s (Mosley, Harrigan, and Toye, 1996a, p. 45). The legal implications of failure to comply with pre-conditions might be less severe than that with conditions regarding tranching policies. This, however, does not diminish the effectiveness of these conditions in influencing the borrowing government. Considering the indirect effect of the BWIs adjustment lending in influencing the borrower’s ability to attract other external financing, the government is usually under pressure to reach an agreement with either the IMF or the Bank in order to bring in other financial resources. Under these circumstances, the chances are pretty high⁵⁹ that the borrowing government will try to implement these pre-conditions in order to reach an agreement with either the IMF or the Bank, or both, for a loan.

As a result, although failure to comply with conditionality does not always trigger legal consequences, conditionality does, to a certain degree, empower the BWIs to

⁵⁹ For example, exchange rate is identified by Killick as a classic example of a pre-condition stipulated by the IMF (Killick, 1998, pp. 6-7). Strong association between the IMF programmes and significant exchange rate depreciation has been identified by Killick (Killick, 1995a, p. 127).

influence the borrowing developing country members. In cases where the legal consequences of non-observance are specifically provided in either the decisions of the BWIs or the legal or quasi-legal instruments relating to an adjustment lending, the borrowing government is legally required to implement the conditions agreed. Simply to let these legal consequences to be known to the borrowers or potential borrowers can itself serve as a very effective tool for the BWIs to influence the borrowing developing countries.

A number of considerations have rendered the assessment of conditionality and a general conclusion with regard to the implementation of conditionality difficult. For example, different yardsticks by which to gauge the results of policy implementation are adopted by the BWIs, on the one hand, and research institutions and NGOs, on the other hand⁶⁰. In addition, various methodologies exist in evaluating the programme outcomes (Killick, 1995a). As a result, the degree of implementing conditionality in various countries has been inconclusive⁶¹. The uncertainty and lack of consensus in evaluating the effectiveness of conditionality do not diminish the important role conditionality has played in influencing the developing countries. Apparently, from the continuous application of conditionality in the adjustment lending operation, in spite of the uncertainty and lack of consensus over their effectiveness, the BWIs still regard it as an effective tool to employ in influencing their developing country members. Moreover, factors influencing the compliance with conditionality have been identified without

⁶⁰ The difficulties in evaluating the effectiveness of conditionality is a reflection of the pitfalls encountered in determining the effectiveness of the SAPs, which will be discussed in more detail in Chapter 3.5.

⁶¹ For example, the IMF has conducted a research reviewing the experience under the ESAF, and the conclusion of this research is broadly positive (Schadler et al, 1993). However, Killick identified certain methodological issues of which the IMF research had not taken into consideration (Killick, 1995a). This is only one example illustrating the degree of differences in conclusions reached by different institutes. The differences will be born in mind throughout the present study when references are made to certain results in the various research conducted by different institutions.

difficulties by various institutions. The domestic political consensus for the reforms and the institutional capacity of the administration to carry out the conditionalities are among those factors (Reed, 1992; Jayarajah and Branson, 1995). The former factor, branded as a variable affecting “programme ownership”, will be subjected to more examination in Chapter 3.5.2. In addition, as pointed out in the external evaluation of the ESAF operation, “... all the available evidence suggests that conditionality-intensive programs seldom succeed in achieving their objectives” (IMF, 1998b, p. 36). Considering the weak institutional capacity in some of the developing countries, it is not surprising to see the conclusion reached by the IMF itself.

Limited environmental considerations have been taken into account in some of the more recent Bank SAPs, partly as a response to the criticisms from environmental NGOs and some of its member states. However, most of these considerations are dealt with under project loans and institution building (Shihata, 1995, chapter 1)⁶². The World Bank has begun to pay attention to the environmental aspect of SAPs⁶³. Nevertheless, no evidence is yet available to show that environmental aspect has received systematic attention in the Bank’s SAP. As far as the IMF is concerned it has maintained its position that it lacks the expertise to incorporate environmental conditionality and it, instead, will leave any relevant issues or policies to the Bank. In one of its early facilities, however, the IMF took into account energy conservation issues. Under the 1975 Oil Facility, the policy statement, in which the members intended to pursue in achieving a medium-term solution to their balance of payments problems, was required to contain a specific aim to

⁶² Loan covenants relating to the environment have been incorporated in some of the World Bank and Asian Development Bank project loans. The effectiveness of the environmental loan covenants, however, has raised concern within these multilateral development banks themselves for they have been reluctant to suspend disbursements except in the direst of circumstances (Head, 1991).

⁶³ For example, of the 34 adjustment operations approved in FY 1989, 7 contained conditions directly related to environmental management (Webb and Shariff, 1992).

conserve energy. Members were expected to take particular measures to conserve petroleum or to develop alternative sources of energy, even though these measures were not made performance criteria (Guitian, 1981). In addition, considerations other than purely economy wide, such as military expenditure, good governance and social impact of the programme, have been incorporated, or taken into account, in more recent ESAF (IMF, 1995 and 1997; Uvin and Biagiotti, 1996). In fact, the IMF might begin to pay limited attention to the environmental impact of its adjustment programme, as attested by some of the recent PFPs published that contain environmental conditions.⁶⁴⁶⁵

Just to conclude briefly, conditionality in its various forms and with its legal implications in the lending process has become an effective tool in the operations of the SAPs, enabling the BWIs to gain leverage over their borrowing developing country members. In conclusion, the BWIs are equipped with various legal and quasi-legal instruments associated with their operations in, but not limited to, structural adjustment, including the application of conditionality and programme and policy-based lending, to influence the developing countries. As will be demonstrated in the following chapter, innovative mechanisms of the World Bank have begun to employ similar legal and quasi-legal instruments in their operations in order to promote a new goal: assisting the implementation of the FCCC. Before we determine whether the BWIs, in particular the Bank, can play this new role effectively, we need to know for sure that these legal and quasi-legal instruments in the existing operations of the Bank have been effective. Thus,

⁶⁴ More discussion on the environmental aspect of the SAPs, including suggestions of “SAP with a climate safety net” will be conducted in Chapter 5.3.

⁶⁵ For example, the following PFPs published by the governments all contain sections referring to environmental policies: Mali (20 May 1998), Central African Republic (29 May 1998), Cameroon (28 July 1998), Republic of Mozambique (10 August 1998), Uganda (28 October 1998) and Malawi (3 December 1998). In addition, in the Letter of Intent submitted by Indonesia in July 1998, “environment” along with other policy areas such as fiscal, monetary and banking issues, is concluded as one of the policy actions

the next section will investigate whether these legal and quasi-legal instruments have been effective in actually changing the behaviour of the borrowing governments and in achieving the desirable result envisaged by the SAPs

3.5 Effectiveness⁶⁶

“Effectiveness” is a difficult concept that can have many meanings and has been subject to extensive discussion under other disciplines such as international relations (eg Bernauer, 1995; Underdal, 1992). In order to determine whether the BWIs, by employing the SAPs, have been effective in influencing their developing country members’ choice of development path, the present study proposes to look at two different questions. First, have the legal and quasi-legal instruments employed by the BWIs to promote structural adjustment been able to result in changes in a country’s relevant domestic laws and policies? That is, have these instruments been effective in producing an *outcome*? If the answer to the first question is Yes, the second question will be: “Has the resulting change in laws and policies improved the country’s economic conditions as the SAP intended?” In other words, has the resulting policy changes been effective in producing an *impact*?⁶⁷ Only when we are able to have a positive answer to both these questions can it be ascertained in definite that the BWIs are indeed effective in influencing their developing country members through the SAPs.

Detail analysis for the two questions is difficult to conduct because of the lack of the relevant counterfactual knowledge, ie what would have happened if the BWIs had not

that need to be taken. All these documents can be found at the official website of the IMF: <http://www.imf.org>.

⁶⁶ Note that, due to the limited scope of the present thesis, all the empirical evidence used to support the analysis in this section draws from the existing literature in mostly economic discipline on research carried out by either the BWIs or other institutions to evaluate the implementation of the SAPs and conditionality.

intervened. In addition, it might be even more difficult to provide conclusive empirical evidence in answering the second question relating to the economic performance of a country with a SAP — there are simply too many factors at play in affecting the economy of a country⁶⁸. Studies have been conducted by the BWIs and other institutes in evaluating the results of the SAPs and conditionality (eg Killick, 1995a and b, 1996, 1998; Mosley, Harrigan, and Toye, 1996b; Schadler et al, September 1993; World Bank, 1988a). Most of these studies have been unable to reach definitive conclusions as to the effectiveness of the SAPs in inducing policy changes (an *outcome*) and in achieving policy results (an *impact*)⁶⁹. In addition, the limited conclusions reached in these studies even conflict with each other at times⁷⁰. Furthermore, the interpretation of statistical data can be very subjective and can easily be manipulated in conveying messages the interpreter would like the readers to believe⁷¹.

It seems, thus, difficult, if not impossible to have a definite empirically accurate answer to the two questions previously proposed from the existing literature⁷². Does this mean that there is no way to determine the effectiveness of the BWIs' influence on the developing countries? Not necessarily. The discussion that follows will attempt to infer

⁶⁷ As pointed out in Chapter 1, the terms *outcome* and *impact* are borrowed from the school of international relations, in particular its discussion on international regime.

⁶⁸ For example, it is difficult to determine whether the improvement of a country's balance of payments situation is the result of the amendment of its foreign trade law that has been requested under a SAP, or is simply resulted from an increased export of its raw materials that will take place regardless of any SAP.

⁶⁹ Note that the distinction between *outcome* and *impact* are not always made in some of the studies. For example, in the latest study by Killick, there is no indication as to whether the programme effect evaluated is about *outcome* or *impact* (Killick, 1998).

⁷⁰ For example, according to a World Bank study: "conditionality in adjustment loans has been implemented to a substantial extent ..." (World Bank, 1988a). On the other hand, according to another study by Killick, "there is little evidence of a strong connection between SAPs and implementation of policy reform" (Killick, 1995b).

⁷¹ For example, just by playing with the order of words can convey different meaning. Compare the following two sentences and we can have two completely different pictures. "The import of energy conservation machinery has been temporarily cut back in 1997; however, the BOP deficit has been greatly reduced by 10% in the same year." "The BOP deficit has been reduced by 10% in 1997; however, the import of energy conservation machinery has been completely cut off in the same year."

from the available empirical evidence and arguments proposed in the preceding sections answers as conclusive as possible to the two questions proposed. Difficult as it is, effectiveness of these legal and quasi-legal instruments employed by the BWIs in advancing structural adjustment merits further examination for these instruments might have, as will be demonstrated in Chapter 4, been gradually adopted by GEF in its practice. Thus, attempt should not be aborted to establish the effectiveness of these instruments in producing an *outcome* and an *impact* to the extent that even inconclusive insights may be helpful in improving the effectiveness of these legal and quasi-legal instruments.

3.5.1 “Outcome”

As demonstrated so far in this chapter, the legal and quasi-legal instruments associated with SAPs have enabled the BWIs to gain immense leverage over the borrowing developing countries. It has also been pointed out that conditions and policy recommendations set down in various SA instruments, notwithstanding their legal characteristics, have certain effects on the borrowing governments in the sense that failure to comply with these conditions could trigger consequences, such as the suspension of loan disbursement. In other words, the borrowing governments cannot afford to totally disregard conditions and policy recommendations in the SAPs if they wish to receive further financial resources. However, this does not imply that the borrowing government will necessarily adopt and implement such conditions as are required by the BWIs, as can be seen from a significant programme failure rate⁷³.

⁷² The same difficulties in evaluating the effectiveness of BWIs' programmes will again be illustrated in the case study of South-east Asia conducted in Chapter 6.

⁷³ For example, in Killick's study, the uncompleted programmes represented about 53% of all IMF programmes examined between 1979–93 (Killick, 1995a, pp. 61-62). In the evaluation conducted by the

Nonetheless, the leverage of these legal and quasi-legal instruments have certain ramifications on the effectiveness of the SAPs in terms of the ability to induce changes of domestic laws and policies, ie the *outcome*, as the following discussion will seek to demonstrate.

There is no single set of statistical data illustrating the effectiveness of the SAPs in producing an *outcome*. In other words, there is no direct empirical evidence that reveals the relationship between the changes of domestic laws and policies and the introduction of a SAP. It might be possible to obtain from the empirical data some indirect evidence as to the effectiveness of the SAPs in inducing domestic policy changes. The implementation of certain conditions prescribed in the loan agreement might entail legislative procedures⁷⁴. For instance, in the process of reforming public expenditure, the passage of budget requires parliamentary actions. By examining the extent of implementation of these types of conditions might give us a clue as to how effective are the programmes of the BWIs in inducing legislative changes. For example, in the 1992 report on the experiences of adjustment lending conducted by the World Bank, the implementation of conditions in adjustment loans by policy area was illustrated⁷⁵ (Corbo et al, 1992, Table 5-3). In this set of statistical data, full implementation on conditions in "rationalisation of government finance and administration", including the reallocation of public expenditures, which might involve legislative process such as budget appropriation, is estimated at 63%. This is quite significant in comparison with the rate of implementation of all types of conditions in the

Bank in 1992, about 47% of the SAL agreements and 40% of the SECALs agreements concluded between FY 1979–89 were not "fully implemented" (Corbo et al, 1992, Table 5-4).

⁷⁴ The case study on South-east Asia in Chapter 6 will reveal some limited empirical evidence in this aspect: for example, in Thailand where tax legislation was adopted to implement conditions under the two SALs from the World Bank.

⁷⁵ The adjustment loans being evaluated in this report are those implemented between FY 1979–89.

programmes under evaluation, which is only about 66%. Thus, it might be able to infer from this empirical data, albeit indirectly, the effectiveness of the SAPs in producing an *outcome*.

However, such an interpretation might be too indirect and too weak to support the conclusion that the SAPs have been effective at producing policy change. Admittedly, such an interpretation simplifies actions involved in the operations of a government. Take the previous example of public expenditure reform again. The reallocation of budget is only one element in the process of public expenditure reform. Other elements can be implemented without involving legislative process, such as reforming the public employment system and/or eliminating unproductive subsidies. As a result, by looking at the implementation of “rationalisation of government finance and administration” does not necessarily give a full picture as to whether the existence of the SAP has produced a change of domestic laws and policies. Consequently, it is difficult to present empirical evidence, even indirectly, to demonstrate the effectiveness of the SAPs in influencing policy changes. However, by looking at this question from the legal and political perspectives, as opposed to empirical perspective, in the context of the leverage from the legal and quasi-legal instruments of the BWIs programmes might offer other indications.

As long as the required legislative and policy change are mandated and set down specifically in one or more of the SA instruments, the chances are considerably high that the BWIs can be effective in producing an *outcome*. For example, “conditionality” in the Bank’s adjustment loans often includes the preparation or adoption of certain laws and regulations reflecting the policies agreed upon with the Bank (Shihata, 1995, chapter 3). Recalling the tranching policy in the Bank’s adjustment lending and the legally binding effect of Bank’s loan agreement on the borrowing government, conditionality of such

nature will have to be implemented if the borrowing government is to receive the subsequent tranche of a adjustment loan. Furthermore, as the preceding sections demonstrates, the borrowing government cannot afford to totally disregard conditions and policy recommendations in the SAPs if it is to receive subsequent tranche in a loan⁷⁶ or to attract other external financing⁷⁷. What can best demonstrate the government's action in implementing the SAPs than the promulgation of new legislation? The administrative branch in the borrowing government, which has the main responsibility to negotiate and deal with the BWIs, might in some instances put pressure on⁷⁸ the legislative branch for speedier legislative process in order to show the "goodwill" of the government that it is committed to the structural reform required by the BWIs^{79, 80}. It might do so prior to the application of an adjustment loan in order to boost its case in getting the loan⁸¹. It might also do so prior to the disbursement of the subsequent tranche of money in order to demonstrate that the government is adopting the appropriate measures and is eligible to receive the next disbursement, even though some of the economic indicators have not been met⁸². Either of these cases can serve to demonstrate

⁷⁶ That was the result from either loan agreement (in the case of the Bank SAL/SECAL) or decisions of the BWIs relating to lending operations (in the case of the Fund ESAF, ie Instrument to Establish the ESAF Trust Fund), see Chapter 3.2.3 for more discussion.

⁷⁷ That was the result from the informal and indirect influence of the BWIs. See Chapter 3.2.3 for more discussion.

⁷⁸ By examining the political climate for reform within countries under the BWIs programme, Nelson observed that: "With the approval of top-level political authorities, the same small circle of high-level economic officials can put into effect most of the key measures. Where legislative approval is required, *the measures are often pushed through with little debate*, in a crisis atmosphere." (Nelson, JM, 1996, p. 1555.) (emphasis added.)

⁷⁹ This exercise of power is based on a government model with divisions of power among administration, legislation and judiciary. It does not apply to other forms of government such as country in absolute monarchy or countries that are politically anarchic because of civil war.

⁸⁰ This scenario does not equally apply to all the developing countries that turn to the BWIs for adjustment loans. It is more likely to happen, for example, in countries where legislative branch is weaker than the administrative branch.

⁸¹ For example, in the Bank's adjustment loans, a change of legislation is, in some instances, made a condition for the presentation of a loan to the Board of the Bank (Shihata, 1995, chapter 3).

⁸² In the case of the IMF assistance, when the performance criteria has not been observed, the government will need to either negotiate for a waiver, or show that corrective measures have been adopted. In the latter

the possible correlation between the existence of the SAPs and the change of domestic laws and policies.

Therefore, in cases where conditions are set to require preparation or adoption of certain laws and regulations, it seems plausible to argue that SAPs can be effective at producing an *outcome*, although empirical evidence cannot directly support this conclusion. Apart from this lack of empirical evidence, there are other possible flaws in the preceding arguments, however. For example, most of the conditions set down in these legal or quasi-legal instruments are limited to purely economic indicators, rather than a list of laws that require legislature or amendment. As far as the IMF conditions are concerned, they are usually quantified and precise, relating to macroeconomic performance indicators that are already in place and being monitored (Mosley, Harrigan, and Toye, 1996a). Nonetheless, these possible flaws and lack of direct empirical evidence do not invalidate or contradict with the arguments proposed in the preceding paragraphs. For example, it is established that the legal and quasi-legal instruments, in particular the applications of conditionalities and policy-based lending have certain leverage over the borrowing government. Conditions and policy recommendation, which are mostly relating to economic policies in any case, are usually respected by the government for fear of the consequences that might occur in cases where compliance is not observed. To sum up, although direct empirical evidence is patchy, the effectiveness of the SAPs in producing an *outcome* can arguably be demonstrated from legal and political perspectives in the context of leverage the BWIs have on the borrowing

case, the adoption of some relevant laws might serve the purpose of demonstrating the government's commitments to reform.

developing countries through the legal and quasi-legal instruments employed in the SAPs⁸³.

3.5.2 “Impact”

After offering a moderately positive answer to the first question of determining the effectiveness of the SAPs in producing an *outcome*, we will now turn to the second question to investigate the effectiveness of the SAPs in actually producing a desirable *impact*⁸⁴. The lack of counterfactual knowledge, ie what would have happened in the absence of the BWIs intervention, prevents a conclusive determination of whether the induced policy changes have resulted in the kind of economic conditions as the BWIs and their SAP intended⁸⁵. Most of the empirical data has been unable to agree on the improvement of the economies of countries under the SAPs, as the SAP intended to achieve⁸⁶. This might be explained by the unimpressive record of programme and/or conditionality implementation^{87, 88}. The empirical research conducted by the BWIs and

⁸³ Similar conclusion also emerged from some of the existing literature. For example, it is stated by Nelson that: “Whether damned or covertly welcomed, conditionality was widely viewed as *tremendously powerful in altering recipients’ policies and behaviour*.” (Nelson, JM, 1996, p. 1551.) (emphasis added.) Nevertheless, Nelson offers no empirical evidence either to support this claim.

⁸⁴ *Impact* here will refer only to economic aspect since the intended goal of a SAP is to improve the borrowing country’s economic state. As a result, the unintended impact on the poor or on the environment, as has been debated in a lot of the existing literature on structural adjustment, will not be subject to detail examination in this chapter.

⁸⁵ For example, it is admitted in Killick’s study that: “Analytically, it can be very difficult to disentangle the several determinants at work in order to isolate the precise effects of an [international financial institution] programme.” (Killick, 1998, p. 19.) He then proceeds to discuss difficulties associated with various methodologies used in conducting research relating to examining the effect of IFI programmes (Killick, 1998, pp. 19-21).

⁸⁶ For example, the IMF study on evaluating its SAF and ESAF programmes notes that: “ESAF countries remain among the poorest in the world” (IMF, December 1997, p. 33). Although the average improvements in growth and the resources balance were greater for countries under the Bank’s adjustment programmes, the “improvements, in several countries, have not been sustained” (World Bank, 1988a, p. 3).

⁸⁷ For example, in the IMF study on evaluating its SAF and ESAF programmes between 1986 and 1994, it is noted that: “Only one-fourth of all three- or four-year arrangements were completed without significant interruption.” (IMF, December 1997, p. 42.) In the World Bank study on evaluating its adjustment programmes between FY 1979–89, the “fully implemented” “all conditions or actions” in the SALs is 53%

outside institutions do not agree on the degree of programme implementation or of the effect on the economy of countries under SAPs, although there is overwhelming evidence supporting the correlation between the two⁸⁹. In other words, it has been established that conditions and policy suggestions of the SAPs, if properly implemented, can produce the intended *impact* on the country's economy⁹⁰. The problem lies with implementation. Therefore, rather than investigating the impact of the SAPs on the country economy, this section will examine why such an impact has not been observed in the majority of the borrowing countries, ie why SAPs have not been implemented.

If, as the preceding arguments suggest, the leverage derived from the legal and quasi-legal instruments employed by the BWIs has affected the government's attitude towards the conditions and policy suggestions prescribed in these instruments, and has certain ramifications on the effectiveness of the SAPs in producing an *outcome*, why, then, has there been such a patchy record in programme implementation that results in the lack of an *impact*? Could the perception of developing countries toward the BWIs

and 60% in the SECALs (Corbo et al, 1992, Table 5-4). The implementation problem in both the IMF and the Bank have also been pointed out in the study by Killick (Killick, 1998, pp. 29-32).

⁸⁸ Note that some of the studies attribute the lack of economic performance or interruption of programme implementation to external factors, rather than to the failure of the BWIs programmes. For example, the IMF study on its ESAF programmes concludes that "most program interruptions have been the result of factors outside the IMF's control — that is, major political upheavals ... and flagging commitment" (IMF, December 1997, p. 45). Admittedly, it is difficult to distinguish between effect resulting from external factors and from the BWIs programmes. Nevertheless, the methodology and analysis in the reports of the in-house evaluation by the IMF and the Bank have been challenged in other studies (eg Killick, 1995b and 1998) and have to be read "with a degree of caution" (Killick, 1998, p. 21). In another study by Mosley et al on the Bank's policy-based lending, for example, whether the policy reform changes are actually implemented are identified as one of the three elements determining the ultimate impact of adjustment lending on the economic performance of the borrowing countries (Mosley, Harrigan, and Teye, 1996a, chapter 5).

⁸⁹ For example, after reviewing all relevant literature from both the BWIs and outside institutions, Killick concluded that: "Overall, a positive correlation between programme implementation and economic performance could be expected ... In other words, the problem is not with the general thrust of the policies the IFIs are promoting but with the poor executive of these [policies]." (Killick, T, 1998, p. 43.)

⁹⁰ As the case study on South-east Asia in Chapter 6 will demonstrate, policies prescribed by the BWIs for structural adjustment purposes have proved instrumental in the impressive economic growth in South-east Asia in the 1980s and early 1990s. Nevertheless, as one research on South-east Asia showed, these policies were adopted on the governments' own initiatives, in particular in country like Malaysia that did not borrow from the BWIs (Ana Marr, 1996).

and their governance structure play a part in explaining the weak implementation of the *outcome*, ie the changed laws and policies resulting from the existence of the SAPs, and, as a result, affect the effectiveness of the SAPs in producing an *impact*?

Elements that affect the implementation of SAPs have been identified and “borrower or programme ownership”⁹¹ has been suggested as one major element. For example, one of the World Bank reports identified that “of the total 81 operations considered in the statistical analyses, 36 highly satisfactory or satisfactory program outcomes were associated with a very high or high degree of borrower ownership. 23 very unsatisfactory or unsatisfactory program outcomes corresponded to a very low or low degree of borrower ownership.” (Jayarajah and Branson, 1995, p. 15.) There is no equivalent or comparable statistical data on the IMF operations relating to the ownership problem and failure of programme implementation. Nevertheless, the problems of “ownership” have been subject to rigorous examination in the recently concluded external evaluation of the ESAF by a group of independent experts commissioned by the IMF (IMF, 1998b). The correlation between the degree of ownership and successful programme implementation has been observed in several country studies carried out by the external evaluators. There is broad agreement that “ownership is a necessary condition of successful policy reform and program implementation” (IMF, 1998b, p. 21). If correlation between borrower ownership and governance structure of the BWIs can be identified, the argument of the present study that the governance structure of the BWIs perceived as asymmetrical by developing countries⁹² has affected the effectiveness of the

⁹¹ Neither the BWIs nor other research institutions provide clear definition as to what “ownership” is, in particular its legal implications. More discussion to follow in the succeeding paragraphs.

⁹² See Chapter 2 for more discussion on the governance structure of the BWIs and its implications to the relationship between the BWIs and their developing country members.

SAPs can then be verified. This following discussion will thus attempt to establish such correlation.

There is no definition of “borrower ownership”. A World Bank report attempts to identify four dimensions of programme ownership: locus of initiative, level of intellectual conviction among key policymakers, expression of political will by top leadership, and efforts toward consensus building among various constituencies; and four levels within each dimension reflecting the intensity of ownership were proposed (Johnson and Wasty, 1993, pp. 4-5). Nor does the External Evaluation of the ESAF where the problem of ownership is identified clearly define “ownership”. It only notes that “one common theme that runs through perceptions of ESAF at the [recipient] country level is a feeling of a loss of control over the policy content and the pace of implementation of reform program” (IMF, 1998b, p. 20). However, this report looks at the perception of ownership from the donors’ perspective and suggests that donors tend to see ownership as an acceptance by the recipient country of donor-driven priorities and programmes.

Nevertheless, none of these reports from the BWIs offers a clear definition of “ownership”. As for studies carried out by academic institutions, they either indicate that “ownership of, or commitment to, policy reform may be necessary for the BWIs programmes to succeed, it is by no means sufficient” (Mosley, Harrigan, and Toye, 1996a, p. 149), or suggest that “ownership explanation is superficial because it is not set within a framework which explicates *why* ownership should exert so decisive an influence” (Killick, 1998, p. 98) (original emphasis). Nor do these outside studies provide a precise definition or criteria based on which to gauge the intensity of

ownership⁹³. Nevertheless, most of them acknowledged the overwhelming evidence supporting the link between programme implementation and borrower ownership (Mosley, Harrigan, and Toye, 1996a, chapter 5; Killick, 1998, chapter 4).

On the one hand, no indication is given as to what “ownership” entails. On the other hand, from the existing literature that touches upon the issue of “ownership problems,” the focus is mainly on the domestic political economy of and political climate in the borrowing countries, including the internal conflict within the administration or among domestic interests group (eg IMF, December 1997; Johnson and Wasty, 1993; Killick, 1998; and, Nelson, JM, 1996). In addition, the discussion on the legal dimensions of “ownership” are absent from the existing literature. It seems, thus, difficult to establish the correlation between the problem of ownership and the governance structure of the BWIs perceived as asymmetrical by developing countries. Nevertheless, theories on fairness and legitimacy of rules articulated by Franck (Franck, 1995) might provide some clues as to how the asymmetry perceived by the developing countries in the BWIs might be one factor affecting the implementation of the policy recommendations of the BWIs programmes. This can also enable us to examine the issue of ownership from a legal perspective.

According to Franck, fairness discourse is partly “embedded in the decision-making processes of numerous treaty-based organizations”, (Franck, 1995, p. 478) and rules that are perceived as “unfair” or illegitimate or unjust are unlikely to be complied

⁹³ Killick attempts to define an ideal case definition: “Government ownership is at its strongest when the political leadership and its advisers, with broad support among agencies of state and civil society, decide of their own volition that policy changes are desirable, choose what these changes should be and when they should be introduced, and where these changes become built into parameters of policy and administration which are generally accepted as desirable.” (Killick, 1998, p. 87.) This, however, is drawn from the set of four-dimension analysis provided by one of the World Bank research (John and Wasty, 1993).

with⁹⁴. Admittedly, in Franck's study, the governance structure of the international institutions and how it affects the legitimacy or fairness of rules set down by these institutions was not discussed extensively. Nonetheless, he observed that: "... the fairness of international law ... will be judged, firstly by the degree to which the rules satisfy the participants' expectations of justifiable distribution of costs and benefits, and secondly by the extent to which the rules are made and applied in accordance with what the participants perceive as right process." (Franck, 1995, p. 7.) Recalling the asymmetric treatment perceived by the developing countries in the governance structure as well as the wider operations of the BWIs⁹⁵, Franck's observation seems to provide some explanations as to how the governance structure of the BWIs might affect the implementation of the BWIs programmes. Firstly, one of the asymmetries perceived by the developing countries has been that the costs and consequences of adjustment fall almost exclusively on the borrowing developing countries. This might fail to satisfy the participants', ie developing countries in this case, "expectations of justifiable distribution of costs". Secondly, decisions relating to lending operations and conditionality attached have been designed in a governance structure that has been perceived as ignoring the need of developing countries since early 1970s. Under the circumstances, the extent to which decisions and conditionalities are made and applied does not seem to be in accordance with "what the participants perceive as the right process". As a result, it might be arguable that, the perceived asymmetry in the governance structure and operations of the BWIs by developing countries undermine the perception of the

⁹⁴ According to Franck, the concept of "fairness" has two aspects: legitimacy as procedural fairness and distributive fairness in a moral and substantive sense. Franck identified four variables according to which legitimacy is perceived: determinacy, symbolic validation, coherence, and adherence. Nevertheless, these variables apply to the rules themselves, rather than to *how* these rules are made (Franck, 1995, chapter 2).

⁹⁵ See Chapter 2.1.3 and 2.2.1.

“fairness” of rules⁹⁶ set down by the BWIs from the developing countries’ viewpoints⁹⁷. This, in turn, might have affected the compliance and implementation of these rules and conditions prescribed by the BWIs programme by the borrowing governments.

In addition to the aforementioned discussion on the legal aspect of ownership, some existing literature also seeks to identify how the governance structure of the BWIs and its implications on the relationship with developing countries might have affected the intensity of borrower ownership. To start with, none of the research explicitly concludes that such relationship has no impact at all on the intensity of government ownership toward a programme⁹⁸. There are some indications implying how the relationship between the BWIs and the developing countries might affect borrower ownership. For example, according to Killick, the issue of ownership matters because conflicts exist between the interests or objectives of the donors, including the BWIs, and the recipient. These conflict of interests are expected because, *inter alia*, donors and recipient governments are answerable to contrasting constituencies (Killick, 1998, chapter 4). Referring to the BWIs as a specific case on the donor side, it was stated that: “they [international financial institutions] have to remain within the policy parameters set by

⁹⁶ Admittedly, the term “rules” here refers to “legal” ones while the conditions prescribed in the BWIs programmes are economic ones in the majority of the SAPs. Nevertheless, it does not invalidate the application of Franck’s theory to analyse the implementation of the BWIs programmes since it is the process of decision-making that is of concern in both cases.

⁹⁷ Note that the present study does not focus on the fairness of the BWIs as international institutions *per se*. It merely tries to demonstrate that, based on Franck’s theory of “fairness,” rules and conditions prescribed by the BWIs might be perceived as “unfair” by developing countries because of the perception of asymmetry and might, as a result, undermine the compliance and implementation of these rules and policies.

⁹⁸ Although the World Bank study on borrower ownership suggests that the “nature of government-Bank interaction” has only a limited significance for borrower ownership, it does recognise that the importance of government-Bank interaction for the ownership issue “varies from region to region and from country to country, depending on both the specific technical needs and capabilities of the particular region and country and the prevalent political situation affecting the Bank-country relationship” (Johnson and Wasty, 1993, pp. 9-10). Nevertheless, the reference to “government-Bank interaction” in this report is made in the context of how the specific technical needs and capability of, and the prevalent political situation in a country affect the Bank-country relationship. In other words, this reference to the Bank-government

their boards. These in turn (particularly in the case of the IMF) *are dominated by the governments of the G7 industrial countries, which means that IFI management and staff are obliged to try keeping the representatives of these important countries 'on board'.*" (Killick, 1998, p. 92.)⁹⁹ (emphasis added.) In addition, "moral hazard aspects" are also identified as one of the reasons conflicts of interests arise and, in turn, affect the intensity of government ownership. One version where moral hazard is created is when "one party to a transaction does not bear the full consequences of its actions. One of the long-standing complaints about donor-recipient relationship is that *the costs of mistakes fall almost exclusively on recipient governments and peoples.*" (Killick, 1998, p. 93.) (emphasis added.) Both of these aspects remind us of the asymmetric treatment perceived by the developing countries under the BWIs: a decision-making process dominated by developed countries, and unequal distribution of costs and consequences of decisions and programmes made by the BWIs.

Furthermore, the present study also infers that the governance structure of the BWIs, and the resulting asymmetric treatment perceived by their developing country members, might be able to affect some of the four dimensions identified by the World Bank as mostly relevant to determine government ownership. One such dimension identified by the Bank is the "level of intellectual conviction among key policymakers" (Johnson and Wasty, 1993, p. 4). From the Bank's report, the "key policymakers" are understood to refer to "domestic" policymakers. The level of intellectual conviction *among* key policymakers presumably includes that *of* key policymakers. The level of

interaction is different from the BWIs-developing country relationship examined in the present study that looks at the role of developing countries in the decision-making process in and operations of BWIs.

⁹⁹ Killick later developed 15 hypotheses to test the applicability of agency theory in conditionality problem. One of the hypotheses is to inquire the correction between programme implementation and this conflict of interests between donors, including the BWIs, and recipient. The survey in all 21 cases studied

intellectual conviction of key policymakers about the nature of the crisis and the necessary remedial actions can be affected by the perception of the borrowing government toward the BWIs, which play no small roles in providing policy advice regarding, for example, the necessary remedial actions to the borrowing government. When the developing countries feel that their needs are not adequately reflected in the decision-making process of the BWIs¹⁰⁰, such policy advice might be deemed inadequate from the borrowing governments. As a result, it seems doubtful that the level of intellectual conviction of key policymakers in the borrowing government will be high.

Another dimension determining borrower ownership is the “efforts toward consensus-building among various constituencies” (Johnson and Wasty, 1993, p. 5). The constituencies here, again, presumably refer to “domestic” agencies within or out the central government. Arguably, the efforts toward consensus-building among various constituencies cannot even begin if consensus cannot be built between the government and the BWIs in the programme and conditionality design. With tools such as conditionality and policy-based lending that entail a certain coercive element, “consensus” seems difficult to build. As one commentator puts it: “Whether publicly acknowledged or not, coercion is often applied to make a country accept what, in the opinion of the country, is not in its interest. Needless to say, *this coercion, an inherent element in a conditionality package, undermines ‘ownership’.*” (Dasgupta, 1998, p. 86.) (emphasis added.) Furthermore, considering decisions relating to conditionality and policy-based lending are made and approved by the Board of Executive Directors, where developing countries’ need are not adequately addressed from developing countries’

showed that in 17 cases “programme implementation is prejudiced when the objectives of donors and governments differ, resulting in conflicts of interest” (Killick, 1998, Table 5.1).

viewpoint, it seems even more difficult to reach a consensus between the BWIs and the borrowing government.

Another way to look at borrower ownership is, as suggested in the report of External Evaluation of the ESAF, to look at the perception of ownership from the donors' perspective. This report notes that donors tend to see ownership as an acceptance by the recipient country of donor-driven priorities and programmes. Putting the donors' perception of ownership in the context of the governance structure of the BWIs where donors have the majority decision-making power, the present thesis proposes that the intensity of ownership over the BWIs' programmes might be undermined because of conflict of interests between donor and recipient. Under the present governance structure of the BWIs, donors have the ability to push through decisions relating to lending operations in the Executive Boards, and the application and impact of these decisions fall largely on developing country members. In the actual negotiation process where policies and programmes are drawn up, recipient developing countries will also bear in mind the fact that final decision of the loan lie at the hand of Executive Directors and, consequently, has to take into account possible donor priorities when concluding policies and programmes. As a result, the borrowing governments might agree to a set of policies that they might not regard as reflecting their own priorities.

The reference to the limited existing literature and analysis inferred by the present study so far have revealed that the governance structure of the BWIs and its reflection on the relationship between the BWIs and the developing countries can affect the intensity of ownership of a BWIs programme. In addition, through examining the legal aspect of

¹⁰⁰ This dissatisfaction is voiced, for example, at the Seventh Ministerial Meeting of the G-24 as early as in 1974: "Present quotas and voting power in the Fund do not reflect adequately the needs or the importance of the developing countries in the world economy." (reprinted in: Sauvant, 1981, Vol. V, p. 307).

ownership based on Franck's theory of "fairness", the present study is able to demonstrate how the asymmetric governance structure and operations of the BWIs might have affected the implementation of the programme. If we recall the evidence stated at the beginning of this sub-section, correlation has been established between programme implementation and the *impact* of the SAP. Thus, although direct empirical evidence is not readily available, the governance structure of the BWIs has arguably undermined the effectiveness of the SAPs in producing an *impact* through its various implications on borrower ownership. Admittedly, it has not been possible to gather empirical data to support the possible correlation between the intensity of ownership and the governance structure of the BWIs. In addition, there are other factors at play in determining the intensity of borrower ownership. Nonetheless, it cannot be denied that, from the aforementioned examinations, the relationship between the BWIs and the borrowing developing countries, which is influenced by the governance structure of the BWIs, does have its ramifications on "ownership" and might have, as a result, undermined programmes and conditions implementation and the effectiveness in producing an *impact*.

To conclude, the effectiveness of the SAPs in producing an *impact* and the implications of the governance structure of the BWIs on this effectiveness might be impossible to ascertain empirically. Nevertheless, empirical evidence has been provided to demonstrate the correlation between effectiveness in producing an *impact* and the extent to which SAPs are implemented, as well as the relationship between programme implementation and borrower ownership. In addition, the preceding arguments presented in the present thesis manage to provide some rudimentary correlation between governance structure and borrower ownership. Thus, the relationship between the BWIs

and the developing countries, governance structure being an important part of that relationship, seems to have its implications on the effectiveness of the SAPs in producing an *impact*. The following section will continue this discussion and examine the relationship between the BWIs and the developing countries and how this relationship have affected the effectiveness of the legal and quasi-legal instruments employed in the SAPs to influence developing countries.

3.6 Relationship with the developing countries

From the preceding sections, this thesis has shown a significant correlation between the effectiveness of the legal and quasi-legal instruments employed by the BWIs to influence the developing countries, and the relationship between the BWIs and their developing countries. On the one hand, these instruments, such as conditionality and programme and policy-based lending, because of and/or despite of their legal characteristics, have enabled the BWIs and their SAPs to gain certain leverage over the borrowing governments. That is to say, the borrowing governments have to seriously take into account conditions and policy recommendations prescribed in these instruments. This leverage has its implications on the effectiveness of the SAPs by increasing their likelihood of inducing changes in domestic laws and policies, ie of producing an *outcome*.

On the other hand, the leverage that results in such effectiveness probably has, ironically, decrease the likelihood of achieving the intended results of the SAPs, ie of producing an *impact*. To put this leverage of these legal and quasi-legal instruments in the context of governance structural of the BWIs might help us to perceive the asymmetry problems in the BWIs more clearly. Decisions relating to the design and

approval of these legal and quasi-legal instruments have been made under a governance structure long perceived by developing countries as unable to reflect their needs or importance in the world economy¹⁰¹. On the other hand, the costs and consequences of these BWIs programmes fall mostly, if not exclusively, on the developing countries. Both of these perceptions have affected the perception of “fairness” of the rules adopted under the BWIs from developing countries’ viewpoint, and rendered the voluntary compliance of these rules difficult. Furthermore, these perceptions have also affected the relationship between the BWIs and their developing country members¹⁰², and had implications on factors influencing the degree of programme ownership. It is, thus, understandable how the governance structure perceived as asymmetric by developing countries can affect “borrower ownership,” one of the key elements required for successful programme implementation and result. Although the preceding section cannot provide direct empirical evidence to support such association between governance structure and the effectiveness in producing an *impact*, indirect evidence, reference to existing literature and rigorous analysis have nevertheless depict the possible correlation.

When the ideal model of development was perceived as economic growth and industrialisation and was promoted by the BWIs through SAPs and the legal and quasi-legal instruments employed, the relationship between the BWIs and the developing countries has been anything but harmonious. As a consequence, the effectiveness of the SAPs has been, on the one hand, observed in producing an *outcome* but, on the other hand, undermined in producing an *impact*. When sustainable development emerged as a

¹⁰¹ See, for example, Communiqué of the Seventh Ministerial Meeting of the G-24, 9-10 June 1974.

¹⁰² Calls for international monetary reform and a new international economic order, including the proposal to reform voting power and quota allocation in the Fund, have been expressed by developing countries since the 1970s (eg UN General Assembly Resolution 3347[XXIX], “Reform of the international monetary system”, 1974; Resolution 3362[S-VII] “Development and international economic co-

new development paradigm and the World Bank began to embark on a new role in assisting the implementation of MEAs in developing countries and establish innovative mechanisms as a response, the relationship between the Bank and its developing country members has undergone certain transformations. As the next chapter will demonstrate, GEF, one of these innovative mechanisms, might have begun to adopt the legal and quasi-legal instruments employed by the BWIs in the SAPs, but in combination with their own novel governance structure different from that of the BWIs. How will this new development affect the relationship between the World Bank and the developing countries and, in the process, affect the effectiveness of these legal and quasi-legal instruments adopted to achieve a new objective are to be investigated in the next chapter.

operation", 1975.) Nevertheless, as the governance structure of the BWIs is concerned, these calls for reform have yet to be materialised two decades later.

CHAPTER 4: WORLD BANK'S INNOVATIVE MECHANISMS

The previous chapter looked at the existing mechanism, the SAPs, employed by the BWIs to influence the developing countries. This chapter will focus on the innovative mechanisms established, or in the process of being established by the World Bank, after the 1990s, in response to the new role assumed by the Bank to assist the implementation of the FCCC. After an introduction to the establishment and operations of all these innovative mechanisms, GEF will be subject to closer examination. The novel governance structure will be delineated firstly, followed by discussion on whether certain legal and quasi-legal instruments, conditionality and policy-based lending in this case, similar to the SAPs have begun to develop in GEF operations. The chapter will conclude by investigating the new relationship between the Bank and its developing countries in the light of these new mechanisms and, more specifically, how GEF has injected a new dimension into this relationship.

4.1 Introduction, establishment and operations

4.1.1 Reasons for the new mechanisms

As pointed out in Chapter 2, the World Bank entered into a different relationship with its developing country members in the 1990s when it undertook to channel funding to the developing countries for their domestic compliance with the MEAs. That partially resulted from the changing socio-economic and political environment after the 1990s when sustainable development had been actively promoted in various international forums. In addition, as MEAs proliferated, developing countries found it more difficult to implement these MEAs with their limited resources and were in need for external

assistance¹. In addition, the interaction between the BWIs and the MEAs, in particular the FCCC became more extensive because of the increasing overlap in their areas of competence². As these developments unfolded, the management of the Bank began to initiate innovative mechanisms either within the Bank itself or in collaboration with other international bodies in the 1990s. As Sir Joseph Gold observed: “the tendency of the Bank has been to establish new international organisations³, with structures tied to the structure of the Bank, when new purposes have been undertaken, rather than to amend the Articles of the Bank.” (Gold, 1981–82, p. 505.) The same tendency can be observed in the way in which the Bank set up new mechanisms, such as various new types of loans, and borrow from other legal concepts, such as the concept of a trust fund. When the new demand for resources needed to implement the FCCC, the management of the Bank, rather than amending the existing mechanisms, created some innovative mechanisms after the 1990s, which we will now examine.

4.1.2 Establishment and operations

4.1.2.1 GEF P and I: establishment and operations

A. ESTABLISHMENT

When sustainable development was called for in the Brundtland Report in 1987, a significant increase in financial support from international sources for developing countries had already been identified as crucial for achieving sustainable development. For example, it was suggested that “a special international banking programme or facility

¹ Nevertheless, developing countries do not want an environmental-related financial mechanism to be linked to the World Bank, as we can see from the heated debate between developed and developing countries over whether GEF P should become the financial mechanism of the FCCC and CBD. See the following paragraphs for further discussions.

² This interaction will be analysed in more detail in Chapter 5.2.2.

³ The new international organisations here refer to the IDA, the IFC, and, later, the ICSID.

linked to the World Bank” (World Commission on Environment and Development, 1987, p. 338) should be considered to provide loans for the development and protection of critical habitats and ecosystems. Since that time, ie the late 1980s, governments, international institutions and non-governmental organisations (NGOs) have proposed various proposals⁴. The proposal put forward to the Development Committee of the IMF and the World Bank by the French government in September 1989 proved to be the most feasible⁵ and led to the establishment of the GEF pilot phase (GEF P)⁶. The French proposal was considered and studied by the World Bank⁷ before a series of negotiations began in 1989–91. The negotiations⁸ mainly took place between and among the World Bank and the donor countries, ie the developed countries. The participation and the role of the recipient countries, ie the developing countries, were considered only at the final meeting in November 1990 (Sjoberg, 1994).

GEF P was set up by a Bank Resolution, (Resolution No. 91–5) which was approved by the Board of Directors on 14 March 1991. GEF P, administered jointly by the Bank, UNEP and UNDP, was to operate for three years from July 1991 to June 1994. It was to provide “new and additional financial resources⁹” to finance the “incremental costs¹⁰” of projects in developing countries that addressed four global environmental

⁴ For an historical account and the various proposals produced, see Sjoberg, 1994.

⁵ The French initiative gained the greatest momentum for, as one commentator notes “putting money on the table before the purpose was specified” (Sjoberg, 1996, p.150) — the French Finance Minister pledged FFfr 900m support over a three-year period to back up its proposal.

⁶ The abbreviations used here follow the ones used in all the official documents of GEF: the restructured GEF is referred to as GEF I while the pilot phase is referred to as GEF P.

⁷ For more information on the World Bank’s investigation of this proposal, see Sjoberg, 1994.

⁸ The negotiations leading to GEF P can be characterised as part of the North-South position in negotiating the UNCED documents, including the two binding conventions, ie the FCCC and the CBD. For further discussion on the climate change negotiation in the context of different perspectives from the North vs. the South and its ramification on GEF negotiation, see Hyder, 1992; and Paterson, 1996.

⁹ The “financial resources” refers to those from official development assistance (ODA). The financial resources provided under the GEF P are to be new and additional to the existing ODA flow to developing countries.

¹⁰ “Incremental cost” is defined as: “the difference between the costs of a project undertaken with global environmental objectives in mind, and the costs of an alternative project that the country would have

problems: global warming, pollution of international waters, destruction of biodiversity, and depletion of stratospheric ozone. Various controversial issues¹¹ surrounding the negotiations of GEF P remained unsettled even after the pilot phase became operational¹² and continued to be subject to intensive negotiation leading to the restructuring and replenishing of GEF.

By early 1992, pressure to reform the experimental GEF P came from both the donor and the recipient countries, as well as from NGOs. In addition, an independent evaluation team, commissioned by the World Bank in 1992, which published its report in 1993, turned out to be critical of GEF P's operations (UNEP, UNDP, and World Bank, November 1993)¹³ and added strength to the calls for reform (Jordan and Werksman, 1994a). Furthermore, restructuring was called for before and during the negotiations of the UNCED if GEF was to serve as the financial mechanism for the two Conventions¹⁴

implemented in the absence of global environmental concerns" (GEF, July 1995). Nevertheless, the term has yet to be clearly defined and has attracted keen debate among NGOs and academics. See, for example, Jordan, 1994; Jordan and Werksman, 1994b; and, Werksmans, May 1993a.

¹¹ For more detailed discussions on some of these controversial issues, see Gan, 1993 (for the individual roles of the three implementing agencies and the roles played by governmental agencies and NGOs), Jordan and Werksman, 1994b (for the discussion on additionality and incrementality), Mintzer, 1993 (for the discussion on incremental costs), Reed, 1991 (for the relationship between GEF and NGOs), Werksman, 1993a (for the legal analysis on incremental costs under the FCCC), Werksman, 1995 (for the discussion on the relationship between GEF and the Conventions for which the restructured GEF P was to serve as the interim financial mechanism), and World Wildlife Fund for Nature, 1993 (for the four focal areas for which GEF P was to provide its financial support).

¹² Despite some controversies surrounding the operations of GEF P, the speedy negotiation leading to its establishment was nevertheless held to be a remarkable achievement in creating a mechanism within the existing international institutions to provide funding for developing countries in pursuing sustainable development. This characteristic of "speed" in the negotiations of GEF P can also be identified in the current operations of GEF I. However, this speedy operation was questioned to have been carried out at the expense of the quality and sustainability of the projects proved (Jordan, 1994). In addition, the expedited process of project approval should not be used alone as evidence demonstrating that GEF I has been fundamentally reformed in terms of its project qualities and performances.

¹³ For the assessment of this independent evaluation report, see Fairman, 1994. More discussion on this independent evaluation report will be conducted in Chapter 5.4.

¹⁴ Article 21.3 of the FCCC designates GEF as its interim financial mechanism only after GEF P was "appropriately restructured and its membership made universal to enable it to fulfil the requirements of Article 11 [financial mechanism]". Article 39 of the CBD also designates GEF as its interim financial mechanism on the condition that "it has been fully restructured in accordance with the requirements of Article 21 [financial mechanism]".

and Agenda 21¹⁵. That was the compromise between the developed countries, which preferred GEF over a new international financial mechanism for the greater control they have had over the GEF P¹⁶, and the developing countries, which argued for a new funding mechanism separate from the World Bank¹⁷.

The negotiations to restructure and replenish GEF P began in December 1992¹⁸. The negotiations completed in Geneva on 16 March 1994 when the Instrument for the Establishment of the Restructured Global Environment Facility (GEF Instrument) was accepted by the participants and was to be adopted by the Implementing Agencies (IA) according to their respective rules and procedural requirements¹⁹. The negotiations focused on what may be regarded as the “unfinished business” of GEF P (Silard, 1995), such as attracting universal participation and reforming the governance system of GEF P²⁰. The donor countries have pledged just over US\$ 2bn during 1994–97 for the restructured GEF (GEF I), which was less than the US\$ 3–4bn mooted at Rio (Jordan and Werksman, 1994a). The latest negotiation round for replenishment finished in March 1998 and member governments agreed to replenish US\$ 2.75bn to cover the period 1998–2001.

¹⁵ Chapter 33 of the Agenda 21 requires that GEF should be restructured for, inter alia, a “universal participation” and “transparent and democratic governance”, with “a balanced and equitable representation of the interests of developing countries” and “due weight to the funding efforts of donor countries”.

¹⁶ GEF was established by a World Bank Resolution and all the decision-making powers for GEF were vested in the Bank, which was also reflected in the procedural arrangements for operational co-operation among the UNDP, UNEP and the Bank (Werksman, 1995).

¹⁷ Much of the scepticism of GEF P concerned the close relationship it has had with the World Bank, whose decision-making process, ie the Bretton Woods style weighted voting system, has given the donor countries far greater voice in the operations of the World Bank.

¹⁸ For further discussion on the negotiations of GEF restructuring and replenishment, see Sjoberg, 1996.

¹⁹ GEF Instrument was adopted by the World Bank’s Executive Directors on 24 May 1994, by the UNDP’s Executive Board on 13 May 1994, and by UNEP’s Governing Council on 18 June 1994.

²⁰ For further discussion on GEF I, see Silard, 1995 (from the perspective of one of the Implementing Agencies, the World Bank), and: Jordan and Werksman, 1994a; and Werksman, 1995 (both from a more critical perspective delineating issues that have not been resolved by GEF I).

B. OPERATIONS

GEF P consisted mainly of the Global Environment Trust Fund (GET), Co-financing Arrangements with the GET and Ozone Projects Trust Fund²¹ (Resolution 91–5, para. 1). GEF I has a single trust fund, the GEF Trust Fund, into which the GET is merged (GEF Instrument, para. 8)²². The operations of GEF P mainly focused on the expedited project identification, assessment and money allocation, rather than actual money disbursement (Jordan, 1994). During GEF P, a total of 115 projects were approved with the committed funding of US\$ 733m, of which 41 projects with the committed funding of US\$ 259m (representing approximately 35% of the total committed funding) was allocated for climate change. During GEF I, the amount of approximately US\$ 2.1bn was approved between February 1995 and October 1998, of which approximately US\$ 776m, or 40% of the total committed funding was allocated for climate change (FCCC/CP/1998/12/Add.1). Compared with the three-year pilot phase, GEF I has been operating at a more expedited speed in terms of project approval²³. However, that alone should not be regarded as evidence demonstrating the improvement of GEF I compared with GEF P, the evaluation of which has to be based on the qualities of the projects implemented. That evaluation is still difficult to conclude since the actual

²¹ For further discussion on utilising the concept of “trusts” in common law to establish new international financial mechanisms to provide financial resources to assist developing countries implementing international environmental agreements, see Sand, 1995. As for the Bank’s operation in establishing trust funds, see the following section for further discussion.

²² The Multilateral Fund of the Montreal Protocol is under a separate governance body, the Executive Committee, and is continued under formally separate arrangements (World Bank Executive Directors’ Resolution No. 94–3, May 24 1994, cited in Silard, 1995). The legal relationship between the Protocol and GEF no longer exists; however, an operational relationship still exists between the Protocol and GEF P in that staff of the Implementing Agencies who work on GEF projects also provide technical assistance in the development of Protocol Project (Reed, 1991). For further discussion on the Multilateral Fund of the Montreal Protocol, see Patlis, 1992.

²³ Of the total projects approved as of June 1996, 42% (86 out of 201) were approved between FY 1995–96 with 38% (US\$ 454m out of US\$ 1,187m) of the total funding committed.

disbursement has been slower than expected²⁴ and, as a result, not many implemented projects are available for evaluation.

Regarding the scope of GEF I funding, the four focal areas, ie climate change, biological diversity, international waters and ozone layer depletion, remain the same as in GEF P, with the inclusion of land degradation, primarily decertification and deforestation, as they relate to the those areas (GEF Instrument, paras. 2 and 3). This is yet another compromise between donor countries, advocating a more “global agenda” such as climate change; and recipient countries, focusing more on the “local agenda” such as decertification. GEF I remains to provide “new and additional grant and concessional” funding to meet the “agreed incremental costs” of measures to achieve “agreed global environmental benefits” (GEF Instrument, para. 2) without giving clear definitions to any of these terms which have been controversial from the start of the pilot phase negotiations²⁵.

The tripartite arrangement of GEF P continues in GEF I, with the responsibilities of each of the IAs remaining mostly the same²⁶. After the extensive restructuring negotiation, the governance structure of GEF I and its link with the FCCC have, on the other hand, greatly improved, as we shall see in the following discussion.

²⁴ The reason for this slower-than-expected implementation is recognised by the GEF Council and the explanation given is “due to the complexities encountered when implementing GEF projects” (GEF, April 1997).

²⁵ For some of these controversial issues, see Jordan and Werksman, 1994b.

²⁶ For the respective responsibilities of the three Implementing Agencies, see Annex C “Procedural Arrangements among the IBRD, the UNEP, and the UNDP” to the World Bank Resolution 91-5 establishing GEF, and Annex D “Principles of Co-operation among the Implementing Agencies” to the Instrument for the Establishment of the Restructured GEF.

4.1.2.2 Joint implementation–related mechanisms: AIJ and GCI/PCF

In addition to GEF, the World Bank has either participated or begun to promote new mechanisms specifically designed for assisting its members to implement the FCCC. These mechanisms are the Bank's Activities Implemented Jointly (AIJ) programme, and the Global Carbon Initiative (GCI) and its Prototype Carbon Fund (PCF). They operate differently from GEF and the SAP, two other mechanisms employed by the BWIs to influence their developing country members. These new mechanisms are either bilateral in nature, or market-based instruments and the participation from private parties are encouraged. The ways in which they influence developing countries are different from those used by GEF and the SAP, as the following chapter will point out. Nevertheless, their significance in addressing the relationship between the World Bank and its developing country members in the context of implementing the FCCC is no less important.

The Bank AIJ programme entered into a three-year pilot phase in April 1996. The PCF is still under negotiation with potential participants. Both of which seek to explore the possibility of joint implementation²⁷ (JI) as a potential implementation technique under the FCCC. The establishment, operations, and the latest development of these two mechanisms are delineated in the following two sections. Their possible link with the FCCC will be addressed in the end.

²⁷ After the Kyoto Protocol, JI in the FCCC and its Kyoto Protocol has a more limited application referring to JI between Annex I Parties. However, the term JI is used here in a broader sense that includes JI between developed and developing countries.

A. ACTIVITIES IMPLEMENTED JOINTLY (AIJ)

COP 1 to the FCCC in 1995, adopted the decision, as required by Article 4.2(a) of the FCCC²⁸, to establish a pilot phase of “activities implemented jointly” (AIJ) between Annex I parties and non-Annex I parties (Decision 5/CP.1, FCCC/CP/1995/7/Add.1). On a voluntary basis, AIJ involves governments and private companies contracting with parties, governments or private companies, in another country to carry out activities that reduces GHGs in that country. According the decision of the COP, no credits shall accrue to any parties participating in this pilot phase AIJ (Decision 5/CP.1, para. 1[f]). COP 2 in 1996 decided to continue the pilot phase AIJ. COP 3 in 1997, again, reaffirmed its decision 5/CP.1 on AIJ under the pilot phase (Decision 10/CP.3, FCCC/CP/1997/7/Add.1). COP 4 in 1998 decided to continue the pilot phase as well as to begin preparations for a review process of the pilot phase “with a view to the COP taking a conclusive decision on the pilot phase” (Decision 6/CP.4, FCCC/CP/1998/16/Add.1).

Following the COP decisions, the World Bank initiated a three-year programme on AIJ in collaboration with the Norwegian government in April 1996^{29,30}. The Bank helped to implement AIJ pilot projects with the funding from that government. Three AIJ pilot projects, in Mexico, Poland, and Burkina Faso, have received US\$ 6.4m in total from the Norwegian government³¹. Co-financing agreements are established between host country parties and donor. The agreements may, at the request of the host country, include

²⁸ Article 4.2(a) of the FCCC sets down the commitments for the Annex I countries. It stipulates that Annex I Parties “may implement such policies and measures *jointly* with other parties” (emphasis added).

²⁹ Prior to its own AIJ programme, the World Bank and the Norwegian Government have partnered a demonstration programme during 1993–96, in which two projects are carried in Poland and Mexico.

³⁰ Note that the Bank AIJ programme does not represent the AIJ pilot phase authorised by the COP to the FCCC. Other bilateral AIJ projects have been undergoing and undertaken at the same time.

³¹ At least two more projects are near the stage of approval from the host governments and the Norwegian government: an Integrated Agricultural Demand-side Management with the Anhra Pradesh Electricity Board, India; and the Barbados Queen Elizabeth Hospital Fuel Cell Installation Project. For the update of the latest information, see the official AIJ website at: <http://www-esd.worldbank.org/aij>.

provisions that address institutional and political concerns related to AIJ matters. For instance, some host countries may wish to have an explicit clause stating that the present project is “for demonstration purposes only and does not constitute a sale of future emission rights for GHGs” (World Bank, March 1997).

It seems that the Bank AIJ programme involves only the host and donor countries that are parties to the FCCC. In addition, the COP did not designate any implementing, or administrative, agency responsible for carrying out the pilot phase AIJ. The World Bank became involved in a rather incidental manner. Initially, it was GEF that was looking for a co-financing partner in arranging JI projects. Norway showed great interest in participating. GEF later withdrew and the Bank took over and signed a Memorandum of Understanding (MOU) with the Norwegian government. Thus the World Bank assumed this facilitative role in assisting host countries implementing AIJ pilot projects³². The massive experiences in project identification and implementation the World Bank has accumulated during the past might be an important consideration for Norway to accept the Bank as its partner. Despite the presumably bilateral nature of the AIJ between host and donor countries, the World Bank has undertaken a pivotal role in its AIJ programme.

The overall jobobjectives of the AIJ programmes have ben identified by the Bank. The World Bank in accordance with the FCCC requirements and these overall objectives has designed the project selection criteria³³. The pilot projects are expected to be linked to regular Bank and IFC investment projects (World Bank, May 1997a). In the three AIJ projects carried out as of March 1997, two of them — the Polish Coal to Gas Conversion Project and the Mexican ILUMEX Project — have received GEF funding at the same

³² Personal communication with a staff member at the World Bank.

³³ The objectives of the AIJ programme have been identified by the Bank as follows: to maximise learning about AIJ, to promote the long-term objective of the Climate Change Convention, to promote client

time³⁴ while the other — Sustainable Energy Management in Burkina Faso — has been linked to a Bank Project. AIJ projects that are associated with projects of either the Bank (including the IFC) or of GEF are subject to all the Bank's operational procedures and policies, including the competence of the Inspection Panel.

There is no formal governance structure in the Bank AIJ programme since it is essentially bilateral in nature. A Steering Committee that meets semi-annually consists of representatives from Norway and the Bank. The host country does not attend the Steering Committee. The Committee mainly serves as a reporting body to the Norwegian government as to how the AIJ programme is proceeding and how the money is spent. The Bank's AIJ programme is co-ordinated by a small team, relying heavily on input from staff members throughout the Bank, in the Global Environment Division (World Bank, May 1997a).

All pilot projects must be approved and endorsed by the host country government. However, as seen from the preceding discussion, the World Bank has taken most of the responsibility in selecting and identifying AIJ projects in its AIJ programme. The input from the host countries, developing countries as well as economies in transition (EIT), in developing, for example, project selection criteria is unclear. The affect of the AIJ programme on the relationship between the World Bank and the recipients will be examined after introducing another of the Bank's innovative mechanisms — the Global Carbon Initiative.

country development, to explore solutions to the methodological issues, to promote partnerships and private sector participation, and, to identify and select AIJ pilot projects (World Bank, May 1997a).

³⁴ However, there is no formal link between GEF and the AIJ funding. The project reports both pointed out specifically that: "The GEF funding is separate from the AIJ financing."

B. GLOBAL CARBON INITIATIVE (GCI) AND ITS PROTOTYPE CARBON FUND (PCF)

In February 1997, James D Wolfensohn, the President of the World Bank, tasked the Environment Department with exploring the idea of setting up a Carbon Investment Fund (CIF)³⁵, including obtaining feedback from potential investors, as investigating the methodological issues of and a legal framework for a CIF. The Global Carbon Initiative (GCI)³⁶ with the CIF, was first introduced at an internal meeting in the Bank in May 1997, in which various issues relating to the design and content of this mechanism were discussed. Mr. Wolfensohn expressed in public the willingness of the Bank to launch the CIF, should the parties to the FCCC find it helpful, at his speech to the so-called “Rio+5 summit”: the UN General Assembly Special Session on 25 June 1997, New York.

Before COP 3, the Bank had already anticipated that a protocol with binding emissions reductions would be concluded and that collaboration between the parties, at least between Annex I Parties, ie developed countries and EIT, would be allowed to achieve these targets. The Bank, thus, spotted a potentially huge market for carbon trading (“carbon offsets market”) and wanted to position itself as an honest broker between “buyers” and “sellers” by forwarding the CIF. The CIF would act as a market intermediary by obtaining funds from investors (both governments and private sector) and investing in projects which would result in carbon emissions reductions (World Bank, June 1997). The idea was that the Bank, through the GCI and the CIF, would be able to provide a mechanism whereby buyers and sellers of “carbon offsets” (carbon reduction units) could efficiently invest in a pool, or fund, of carbon investments managed by the Bank. In

³⁵ The CIF was renamed as the Prototype Carbon Fund (PCF) after the FCCC COP 3 in 1997.

³⁶ The GCI is to investigate the potential of market mechanisms to reduce global GHGs emissions and to support environmentally sustainable growth for developing countries. The establishment of the CIF is one such market mechanisms the Bank is exploring under the GCI.

addition to the CIF, the GCI has been considering other products, including carbon-neutral products, specific-purpose funds and specific services³⁷.

The GCI has not begun operating yet and the CIF is still obtaining pledges of support from governments and businesses. Several MOUs have been signed with some OECD governments and private companies since early June 1997, in which initial pledges to invest in the CIF are made. After the FCCC COP 3, the CIF has been renamed as the Prototype Carbon Fund (PCF), and will be presented in the Bank's Executive Board Seminar in February 1999. It will seek endorsement from the Bank's Executive Board in its April meeting in 1999, and, if approved by the Board, will be established and open for contribution from governments and private entities in July 1999.

Most of the EIT (economies in transition) countries and some Latin American countries have expressed strong interest in participating in the PCF. In fact, several EIT have already shown great interest in hosting CFP projects (World Bank, March 1998)³⁸. The response from China and the G77 countries are not yet clear at this stage. Therefore, the participation of the developing countries in the preparation of the PCF is not yet noticeable. However, with the emissions trading sanctioned by COP 3 in Kyoto, even the Kyoto Protocol only allows Annex I Parties to participate at the present stage, more positive response to the PCF from other members of the Bank, in particular developing country members, can be expected. In addition, as will be discussed in the following sections, the design of a Clean Development Mechanism (CDM) under the Kyoto Protocol

³⁷ These products have not been developed as fully as the CIF and, thus, will not be discussed in more detail here.

³⁸ In fact, in the initial "Terms of Reference for a Feasibility Study on World Bank Carbon Investment Fund," the CIF was intended to invest in EIT. For the Terms of Reference, visit the website at: <http://www-esd.worldbank.org/cc>.

will also affect the perception of the developing countries in participating in the GCI/PCF³⁹.

The Bank's Managing Director at the first GEF Assembly presented the PCF in April 1998. The potential overlap between GEF projects and PCF projects⁴⁰ is another issue of concern. One of the political risks identified by the Bank staff working on the GCI is that the Bank may be perceived as undermining GEF replenishment, which was under negotiation at the time. The Bank has the following responses to this concern over the potential conflict between GEF and the CIF/PCF. First, the Bank intends to fully honour its commitment to channel GEF resources for eligible investments. Secondly, GEF and the World Bank Group have agreed on their method of collaboration in moving forward on the establishment of the initial PCF. Lastly, the Bank views GEF and PCF funding of climate friendly investments to be complements rather than substitutes (Koch-Weser, April 1998). Nonetheless, this concern might be less of a problem now that the negotiation of the second GEF replenishment has been completed. In addition, distinction will have to be drawn eventually because the two mechanisms serve different objectives. GEF mainly intends to transfer financial and technical resources to the Bank's developing country member, while the GCI/PCF, at its initial stage, will concentrate on EIT countries.

The PCF will develop into another trust fund managed by the Bank. Agreements will need to be signed between the potential donors and the Bank. It is interesting to observe whether contentious issues that occupied the negotiation of GEF P and its restructure will emerge again in the process of setting up the GCI/PCF. Similarities can already be identified between GEF and the GCI: both came from the initiatives within the

³⁹ For further discussion, see Chapter 4.1.2.2.

⁴⁰ According to personal communication with a staff member of the Bank working on the AIJ/GCI, GEF has felt "threatened" by the PCF for potential "competition" from the PCF, in particular with GEF operation in the category of short-term response measure.

Bank, both of their initial negotiations took place between the Bank and the donors (the developed country members) with minimum participation from the developing country member. In the case of GEF, developing countries entered into the negotiation at rather a later stage. However, they managed to secure their interests in GEF I. At the moment, the participation of the GCI from the Bank's developing country members seems rather insignificant. The perception of how beneficial it will be in participating in the GCI will influence developing countries' decisions as to whether to take part in its negotiation. When market-based mechanisms such as emission trading were sanctioned by the Kyoto Protocol as some of the implementation tools under the FCCC, it might be in developing countries' own interests that they take part in the negotiation of the GCI as early as possible in order to safeguard their own interests⁴¹.

Another comparison worth noting is the decision-making structure of the Bank, the GEF Trust Fund, and the PCF. The Bank's policies are guided by the decisions of its Executive Boards, in which its developed country members hold the majority of the votes. In the GEF Trust Fund, the Bank is the Trustee of the fund and is accountable to the GEF Council, which has a more balanced representation from both the developed and developing countries⁴². This, as the following section will show, has in part mitigated the asymmetric treatment perceived by developing countries under the BWIs regime. In the GCI, the decision-making structure is not yet clear. However, in its initial stage of development, it appears that the Bank has been taking the lead in designing the framework of the GCI. The Bank is very likely to serve as the trustee in the PCF or any trust fund created thereof. Since the idea of GCI/PCF was based on the potential market for carbon

⁴¹ Developing countries, for example, can instruct the elected Executive Directors from their constituencies to put into the agenda of the GCI/PCF negotiations interests relating to developing countries, such as the design of the governance structure of the GCI.

trading under the FCCC and the Kyoto Protocol, it might be possible that the GCI could enter into an agreement with the FCCC similar to the one between GEF and the FCCC. If that is the case, the Bank as trustee of PCF may have a similar role to that of the GEF Trust Fund. This can be a positive development in the Bank's favour in terms of improving its relationship with the developing countries and increasing its ability to play a new role in assisting the implementation of the FCCC more effectively.

C. LINK WITH THE FCCC⁴³

Unlike GEF, neither the Bank AIJ programme nor the GCI has established any formal relationship with the FCCC. Since the basic ideas behind their design have progressively been sanctioned by the Kyoto Protocol⁴⁴ and the purpose of their establishment in the Bank was to assist the implementation of the FCCC, it might be expected that some forms of co-operation would emerge eventually.

The Bank AIJ programme is implemented under the auspices of the FCCC, which sets out guidance for the operations of the pilot phase. Nevertheless, the Bank AIJ programme does not play any formal role under the FCCC AIJ pilot phase, or vice versa. Although the Bank designs the project selection criteria, they are, according to the Bank, set in accordance with FCCC requirements. A uniform reporting format for the pilot phase AIJ projects was adopted by the FCCC and reiterated in COP 3. The Bank assists the host countries participating in its AIJ programme to prepare their reports to the FCCC

⁴² More discussion on the governance structure of GEF and the role of the Bank in GEF will follow in Chapter 4.2.

⁴³ "Link" with the FCCC refers to formal but not necessarily legal agreements between the FCCC and any of the mechanisms under the World Bank in arranging the relationship between the two. Examples of this type of "link" include the MOU between the FCCC COP and the GEF Council as discussed in Chapter 4.2.2 and 4.3.

⁴⁴ The AIJ is based on the concept of JI. A pilot phase JI (AIJ) was approved at the COP 1. At COP 3, JI was officially endorsed by the Kyoto despite on a smaller scale limited among developed countries (Kyoto

Secretariat. Because of these arrangements, the relationship between the Bank AIJ programme and the FCCC remains close, notwithstanding the lack of formal link or agreement between them.

As for the GCI and its PCF, no similar arrangement with the FCCC exists. The “Project Selection Guidelines”, on which the Bank will base its investments in projects funded by the PCF, will be developed in consultation with the participants and hosts. At present, thus, the relationship between the PCF and the FCCC does not seem to be as close as that between the GEF and the FCCC. However, it needs to be noted that a mechanism very similar to the GCI was established under the Kyoto Protocol: the Clean Development Mechanism (CDM). Under Article 12 of the Kyoto Protocol, non-Annex I Parties, ie developing countries, will benefit from project activities resulting in certified emission reductions, and Annex I Parties may use the certified emission reductions accruing from such project activities to contribute to compliance with part of their quantified emission limitation and reduction commitments under Article 3 of the Protocol. The relationship between the Bank’s GCI/PCF and the CDM remains to be seen⁴⁵. At the moment, the Bank does not seem to envisage a formal relationship between the PFC and the CDM. Whether the Bank will be designated as the operational entity to certify emission reductions (Kyoto Protocol, Article 12.5) or whether the PCF will serve as the fund that will be assisted by the CDM for funding the certified project activities (Kyoto Protocol, Article 12.6) are some of the developments that need to be observed closely⁴⁶.

Protocol, Article 6). The GCI/PCF intends to tap into the potential market for emission trading, which is also sanctioned by the Kyoto Protocol (Kyoto Protocol, Article 17).

⁴⁵ More discussion on the relationship between the GCI/PCF and the CDM will be conducted in Chapter 5.4.2.2.

⁴⁶ Whether it is desirable from developing countries’ perspective that such link is to be established will be discussed in more detail in Chapter 5.4.2.2.

In short, the World Bank's two innovative mechanisms do not have such a close link with the FCCC as GEF. However, they enable the Bank to provide additional resources for the developing countries to implement the FCCC, which makes them no less important than GEF in the Bank's effort to play its new role. Nevertheless, the mechanisms, unlike GEF, have less operational experiences and operate differently from the existing mechanism of the Bank such as the SAP. The following two sections will thus turn to GEF for further discussion. The distinctive governance structure of GEF, which has a positive effective on the relationship between the Bank and the developing countries, will be examined first.

4.2 GEF: distinctive characteristics

4.2.1 *Decision-making*

The operations of GEF P were largely influenced by the Bank and have been criticised by both academics (eg Werksman, 1995) and the independent evaluation team (UNEP, UNDP and the World Bank, November 1993). In GEF I, although the tripartite arrangement among the UNDP, UNEP and the Bank continued, the dominating role the latter played during GEF P was diminished in the domain of policy making⁴⁷. In terms of governance, GEF I had an improved structure based on universal participation, as required by the two Conventions and Agenda 21. GEF P was administered by the World Bank as the trustee of GET in accordance with the applicable provisions of the Articles of Agreement, by-laws, rules and decisions of the Bank (Resolution 91-5, para. 1). The Bank reported semi-annually to the participants' meeting (Resolution 91-5, para. 7).

⁴⁷ During GEF P, the operating policies were set by the World Bank with the collaboration of the UNDP and the UNEP; while in GEF I this policy-making power has been transferred to the FCCC and the CBD by their respective COP and to the GEF Council (Silard, 1995). For a more detailed discussion on this

Participants⁴⁸ did not have formal power to determine GEF P policy or to approve GEF P projects, which remained the responsibilities of the World Bank (Werksman, 1995).

The governance structure was reformed in GEF I in response to the demand by developing countries for more participatory and universal decision-making arrangements⁴⁹. Any UN state members or any of the UN's specialised agencies may become a participant in GEF I (GEF Instrument, para. 7)⁵⁰. GEF I has an Assembly, consisting of representatives of all participants; a Council, consisting of 32 members representing constituency groupings, and a Secretariat, headed by a Chief Executive Officer (GEF Instrument, paras. 11, 13, 16, and 21). The Assembly is to meet once every three years to review the general policies, operation and membership of GEF I and to consider amendments to the GEF Instrument (GEF Instrument, paras. 11 and 12). There is no voting procedure prescribed for the Assembly in matters relating to amendments to the GEF Instrument. "Consensus" is to be sought when considering approval of any amendments to the Instrument on the basis of Council recommendations (GEF Instrument, para. 12). Compared to the IBRD, the equivalent of the GEF Assembly in the IBRD will be the Board of Governors. Under the Articles of Agreement of the IBRD, unless otherwise specified, decisions are to be made by a majority of the votes cast. The number

transformation and the legal relationship between and among the World Bank, the COPs, and the GEF Council, see Werksman, 1993b and 1995.

⁴⁸ In order to become a participant, governments are required to make a minimum contribution of SDR 4m either to the GET or to establish a co-financing relationship with the Fund; a country, however, did not have to be a participant in order to be eligible for funding. This "entrance fee" has been heavily criticised by developing countries and by the NGOs, in spite of the financial assistance to some governments provided by bilateral agencies and the IBRD. This fee was waived by the World Bank altogether in December 1992 (Jordan, 1994).

⁴⁹ The fundamental conflict between donor and recipient countries about the governance and decision-making process of GEF mirrors the debate between developed and developing countries over the decision-making process of international institutions in general. Developed countries prefer the Bretton Woods style voting system in which voting power is determined by the financial contribution of the country; while developing countries value the UN style voting system in which votes are equal among countries. See, for example, Jordan, 1994; and, Silard, 1995.

⁵⁰ The "entrance fee" requirement for membership has been waived in GEF I. However, this requirement was still retained in the replenishment negotiations (Silard, 1995).

of votes each governor has depends on the contribution his government makes to the Bank⁵¹ (IBRD Articles of Agreement, Article V, Sections 2 and 3). Formal vote does not take place in the GEF Assembly and rarely takes place in the IBRD Board of Governors in practice. Compared with the developing country Governors in the IBRD, developing country Representatives in the GEF Assembly can be more confident to voice the concerns of developing countries and secure their interests because, under the rules of the GEF Assembly, developing countries will not be “outvoted” by developed countries in reaching important decisions. The restructured GEF, thus, has a governance structure that represents a more collective decision-making process in which more significant participation from the developing countries is secured.

The Council will determine the operational policies of GEF I and the COP to the FCCC, on the other hand, will decide on policies, programme priorities and eligibility criteria for GEF I operations in relation to climate change (GEF Instrument, paras. 5 and 6). The 32 Council members will be selected from constituency groupings, 16 of which will be from developing countries, 14 from developed countries, and 2 from the countries of Central and Eastern Europe and the former Soviet Union (GEF Instrument, para. 16). The Council is to adopt regulations by consensus. Unless otherwise provided, decisions requiring a formal vote by the Council are to be taken by a double-weighted majority, ie an affirmative vote representing *both* a 60% majority of the total number of participants *and* a 60% majority of the total contributions (GEF Instrument, para. 25). The novel design represents a middle ground between the Bretton Woods weighted voting system and the UN one-country-one-vote system. The GEF Instrument mandates the number of Council members representing developing country participants, which is half the total Council

⁵¹ The IMF and the IDA have similar governance structures as those of the IBRD (IMF Articles of

members, while the BWIs do not have similar requirements for elected Executive Directors.

In addition, when circumstance arise when voting is required, developing countries' individual votes can be counted more significantly within the GEF Council than in the Boards of Executive Directors of the BWIs since affirmative votes from *individual* participants constitute half the majority votes required by the GEF Council. Therefore, compared with the Boards of Executive Directors of the BWIs, which are also responsible for making operational decisions and proving loans, the GEF Council has the framework to incorporate different views of developed and developing countries. Although decisions are usually reached upon through consensus, when it comes down to voting, GEF I provides safeguards for developing countries by partially adopting the UN voting system.

As a result the decision-making process was visibly clarified in GEF I. While most of the decisions are made by the World Bank during GEF P, the GEF Instrument set down clear provisions for decision making in GEF I. As a result, this governance structure might begin to balance the asymmetry problem perceived by developing countries in at least the World Bank when it is acting as an IA of GEF I. In addition, the closer link with the FCCC also helps to tilt the balance, as we will now discuss.

4.2.2 *Links with the FCCC*

In terms of links with the FCCC, we will now examine the relationship between GEF⁵² and the FCCC as set down in the GEF Instrument. Compared with GEF P, the GEF Instrument provides clearer provisions regulating the relationship and co-operation

Agreement, Article XII, Sections 2 and 5; IDA Articles of Agreement, Article VI, Sections 2 and 3).

⁵² Unless otherwise specified, the term "GEF" used in this section refers to the restructured GEF: GEF I.

between the two Conventions⁵³ to which GEF serves as an interim financial mechanism, and with other bodies (GEF Instrument, paras. 26–28). According to Article 11.3 of the FCCC, arrangements are to be made by the COP to govern the relationship between the FCCC and the entity or entities entrusted with the operation of the financial mechanism, which, in the present case, will be GEF. Similarly, para. 27 of the GEF Instrument also stipulates that co-operative arrangements or agreements with the COPs to the two Conventions shall be considered and approved by the Council. As a result, a Memoranda of Understanding (MOU) between the COP to the FCCC and the GEF Council was drafted, following the request by a decision made during COP 1, jointly by the two secretariats of the FCCC and GEF.

The GEF Council approved the MOU at its meeting in July 1995 (GEF/C5/8) and by the FCCC COP 2 in July 1996⁵⁴ (Decision 12/CP.2, FCCC/CP/1996/15/Add.1). The Annex to the MOU on the determination of the funding necessary and available for the implementation of the Convention, approved by the GEF Council, at its meeting in April 1996, (GEF/C7/11) has also been approved at the FCCC COP 3 (Decision 12/CP.3, FCCC/CP/1997/7/Add.1)⁵⁵. The purpose of the MOU is to describe the respective roles and responsibilities of the COP and of GEF (MOU, para. 1). It also provides the reporting procedures of GEF to the COP (MOU, paras. 6–8). It reaffirms that the GEF Council will ensure that the operations and funding activities of GEF will be in conformity with the guidance of the COP (MOU, para. 4). It further bestows the COP the

⁵³ For further discussion on the legal relationship between GEF and the COP to the FCCC, see, Werksman, 1995.

⁵⁴ A similar arrangement has also been reached between the COP to the CBD and GEF, which will not be discussed here.

⁵⁵ Paragraph 9 of the MOU stipulates that “the COP and the Council shall jointly determine the aggregate GEF funding requirements for the purpose of the Convention”. The Annex to the MOU is to lay down the procedures to facilitate such a joint determination. This Annex attracts controversies for it needs to determine what is the amount of funds “necessary and available” for implementing the Convention as

right to consider a specific project decision of the Council which is considered by any party to be in violation of the guidance from the COP, and to ask the Council for a reconsideration of that decision (MOU, para. 7). This MOU clarifies certain issues regarding the relationship between the COP and GEF, and confirms the authority of the COP over most of the operations of GEF.

The relationship between GEF and the COP to the FCCC can be analysed from two levels based on the types of GEF operations the Council is to decide: one relates to GEF operations in the focal area of climate change; and the other relates to non-climate change GEF activities. For the climate change-related GEF operations, GEF shall “follow the policies, programmes priorities and eligibility criteria decided by the FCCC COP” (GEF Instrument, paras. 26 and 6). Article 11.3 of the FCCC also stipulates similar provision reiterating the authority of the COP in developing “policies, programme priorities and eligibility criteria related to this Convention”. The MOU approved by the FCCC COP 2 and the GEF Council further asserts the authority of the COP to decide on the climate change-related GEF operations. As a result of these mostly legal requirements⁵⁶ that brings closer relationship between GEF and the FCCC, the developing countries, through the numerical majority and the UN-style voting system in the COP to the Convention⁵⁷, have theoretically gained more leverage over decisions relating to the operations of GEF in climate change-related area.

guidance for the negotiation of GEF replenishment (Werksman, 1995). More discussion on this Annex to the MOU will follow.

⁵⁶ Note that the MOU is a relatively informal document without legally binding effect for the narrow legal capacity granted by GEF Instrument (Werksman, 1995). It has been reiterated further by the GEF Council as follows: “A memorandum of understanding is a form of arrangement that is often used to denote a firm, *but not legally binding*, commitment between two or more organisations.” (emphasis added.) (GEF/C5/8.)

⁵⁷ Although the recipient countries have a numerical majority in the COP, they do not necessarily get a “upper hand” over the decision-making process since “consensus building” is what most of the new MEAs opted for in their decision-making process. For further discussion on the COP to the MEAs, see Werksman, 1996a. Nevertheless, the mechanism does exist in the COP that provides a fairer voting system from the recipient countries’ perspectives.

In the second category, ie the non-climate change-related activities⁵⁸, it is the GEF Council that is responsible for developing, adopting and evaluating the operational policies and programmes for GEF-financed activities (GEF Instrument, para. 15). The structure of and the decision-making process in the GEF Council have, as previously mentioned, been greatly improved compared with that of the pilot phase and, in particular, to that of the BWIs. The recipients are presented more equally as donors in the GEF Council, representing one-half of all Council members. The governance structure provides a framework⁵⁹ in which the developing countries have more chances to voice their priorities and needs on a more equal footing than the donors⁶⁰. In addition, in GEF report to the FCCC COP 2 (FCCC/CP/1996/8) which, noted by the Secretariat, should be seen as an initial implementation of the relevant provisions of the MOU, it was indicated that when GEF provided assistance to countries outside the Convention's financial mechanism, it ensured that the activities were fully consistent with the guidance provided by the COP. The report, albeit a non-legal instrument, demonstrated that the GEF Council is willing to defer to the guidance from COP to the FCCC, and bring a close relationship between GEF and the FCCC. In short, not only does the GEF Council have to comply with COP guidance in its climate change-related activities, it also needs to take into account the same guidance in its non-climate change-related activities.

⁵⁸ The "non-climate change-related GEF activities" referred to here exclude activities in the focal area of biodiversity, the reason being that, as in the case of the FCCC, the COP to the CBD is to decide the policies, programme priorities, and eligibility criteria in relation to the biodiversity-related GEF activities (CBD, Article 21.1 and GEF Instrument, paras. 6 and 26).

⁵⁹ The implications of this novel governance structure of GEF on the actual day-to-day operations of GEF are more difficult to ascertain. Nevertheless, with this more balanced governance structure in place, developing countries can be sure that their votes can be counted more significantly in the GEF Council than in the Executive Boards of the BWIs.

⁶⁰ Although the one-country-one-vote UN system, preferred by the recipients, was not adopted by GEF Instrument, the present system seeks a middle ground between the weighted voting system and the UN style voting system. See para. 25 of GEF Instrument.

Another important aspect of the relationship between GEF and the FCCC is the decision to determine the amount of money donors will contribute. In the case of GEF, the amount of funding necessary and available for the implementation of the Convention has proven to be a very controversial issue. Should the COP bears the main responsibility of determining the “necessary and available” funding GEF is to provide, the recipient countries, ie the developing country Parties, through their numerical majority in the COP, might, and are able to, set the funding at such a huge amount that might, as one commentator puts it, “quickly outstrip donors’ willingness to contribute.” (Werksman, 1995, p. 59) On the other hand, should the donor countries continue to dominate GEF replenishment negotiations, the amount of funding might be deemed insufficient by the recipients to implement the Convention and might, eventually, render the implementation ineffective. Consequently, this aspect of the relationship between GEF and the recipients is no less important than that regulated in the MOU and will be examined briefly now.

The MOU lays down the principle of determining the necessary and available funding by stipulating, in para. 9, that: “... the COP and the Council shall *jointly* determine the aggregate GEF funding requirements for the purpose of the Convention. Procedures to facilitate such a joint determination will be developed by the COP and the Council and annexed to this Memorandum.” (emphasis added.) The “Annex on the determination of funding necessary and available for the implementation of the Convention” proves to be more controversial than the MOU itself because of the differences between the recipients and the donors. It was drafted jointly by the FCCC and the GEF Secretariats in August 1995 and the draft text was approved by the GEF Council at its meeting in April 1996 with one revision, which gave the COP a bit more leverage

over determining the adequacy of the resources available⁶¹. However, COP 2 did not approve the Annex along with the MOU and decided to refer the text adopted by the Council and the draft annex submitted by the G-77 and China for consideration by the Subsidiary Body for Implementation (SBI) at its subsequent session (Decision 13/CP.2, FCCC/CP/1996/15/Add.1).

At the SBI's fourth session, when comments on the Annex from the Parties were received, both the US and the EU, representing the majority of the donors, saw no point of re-drafting the text since the Annex has been approved in the GEF Council "by governments that take part in the work of the Convention" (FCCC/SBI/ 1996/MIS1 Paper No. 3: comment by the US). However, the Annex adopted by the Council met objections from the recipients, representing largely by the G-77 and China, which put forward a rather radical proposal at the fourth session of the SBI⁶² (FCCC/SBI/1996/L4/Rev.1). The different perspectives between the donors and the recipients are clearly reflected in the large discrepancies shown in the Annex adopted by the Council and the draft annex submitted by the G-77 and China in November 1996.⁶³

⁶¹ The original draft states that: "The COP may, in its action on GEF reports, *comment on* the adequacy of the resources available for the implementation of the Convention." (emphasis added.) The adopted text by the GEF Council reads: "The COP may, in its action on GEF reports, *consider* the adequacy of the resources available for the implementation of the Convention." (emphasis added.)

⁶² One cannot help but to notice the forum at which the G-77 and China chose to voice their opinion. The G-77 and China have their own Council Members who can also put forward revisions to the draft proposed by the two Secretariats during the Council Meeting of April 1996. Instead, they chose to promote their own draft Annex through the SBI, a subsidiary body of the FCCC that is to report to the COP. There might be several explanations for this choice of forum. One of the reasons could be that the G-77 and China, representing the majority of the recipients, are still suspicious of the "neutrality" of GEF operations. If that is the case, then the restructuring of GEF in relation to its decision-making process might turn out to be less comprehensive as has been suggested by some commentators.

⁶³ The draft annex submitted by the G-77 and China clearly designated the COP as the sole authority in guiding the GEF replenishment negotiations and determining the necessary and available funding for implementing the Convention. On the other hand, the Annex adopted by the Council urged the COP to take into account "other sources of funding" available for the implementation of the Convention, which could be interpreted as an intention of the donors to rid the GEF as the only source of funding to assist developing countries to implement the Convention.

Considering the large discrepancies in these two texts, it should be held as a remarkable achievement that an annex was approved by the SBI at its fourth session in December 1996 and the recommendation by the SBI for its adoption was accepted at COP 3 (Decision 12/CP.3, FCCC/CP/1997/7/Add.1). The GEF replenishment negotiations will continue to take place within GEF, as commanded by the donors. Nevertheless, the GEF will *fully and comprehensively* take into account the assessment of the COP during the replenishment negotiations, as an assurance that the donors cannot disregard the assessment by the COP. As for the financial resources needed, the relevant provision provides that: "... the COP will make an assessment of the amount of funds that are necessary to assist developing countries ... taking into account ... (b) financial resources *needed* by developing country parties to meet the agreed full incremental costs of implementing measures that are covered by Article 4.1 of the Convention *that are agreed between a developing country party and the international entity or entities referred to in Article 11 of the Convention.*" (emphasis added.) This language is similar to Article 4.3 of the Convention which stipulates that the agreed full incremental costs of implementing measures covered by Article 4.1 are to be agreed between developing country Parties and the international entity or entities entrusted with the operation of the financial mechanism.

Overall, judging from the text adopted by the SBI and the COP, it seems fair to conclude that, although the donors still managed to keep the GEF Council, rather than the COP, as the main forum for GEF replenishment negotiations, the recipients also managed to put in enough safeguards in the Annex to ensure that the donors could no longer dominate the process of determine the amount of GEF funding and that their

interests and needs can be guarded by the COP⁶⁴. This demonstrates that a delicate balance between the donors and the recipients has been reached and this Annex could further improve the relationship between GEF and the recipients, and adjust the imbalance usually associated with the traditional relationship between donors and recipients in similar type of international financial institutions.

In the first GEF Assembly held in New Delhi, India in April 1998, the participants adopted a New Delhi Statement, which contains 10 preambular and 12 operative paragraphs. Relationship is further clarified between GEF and the IAs, including the World Bank. The Statement specifies that: "GEF Implementing Agencies should promote measures to achieve global environmental benefits within the context of their regular programs and consistent with the global environmental conventions while respect the authority of the governing bodies of the Implementing Agencies." (New Delhi Statement of the First GEF Assembly, para. 9.) This Statement reiterates the importance of "mainstreaming" the existing operations and programmes of the Bank, which could, indirectly, enhance a still closer link between the Bank and GEF by appealing to the Bank to "mainstream" its regular programmes so that these programmes would be consistent with the global environmental conventions⁶⁵.

In conclusion, as a result of the clearer provisions in the GEF Instrument, the MOU between the GEF Council and the COP to the FCCC, and in the New Delhi Statement, a closer link between GEF and the FCCC was established. GEF should follow guidance from the COP in climate change-related project and take into account guidance

⁶⁴ How this formula works in practice and whether the interests of the recipients can be guaranteed are difficult to evaluate at the moment. The latest round of negotiation of GEF replenishment took place between 1997-98 when the Annex to the MOU was still under debate in the GEF Council and the FCCC COP. Although the negotiation round continued in 1998 after the FCCC COP 3 has approved the Annex to the MOU, it remains unclear whether this formula has had any impact on this round of replenishment negotiation.

from the COP in non-climate change-related project. The COP to the FCCC has a UN-style voting system where developing countries can feel more confident to put forward their environmental and developmental agenda. This closer link between GEF and the FCCC might be able to change the traditional relationship between the developing countries and the World Bank as one of the IAs of GEF. The following discussion will examine more specifically the implications of GEF for the World Bank.

4.2.3 *Implications for the World Bank*

By taking a major part in the establishment of GEF P, the Bank has embarked on a new role, one that was identified in Chapter 2⁶⁶. During the negotiation of GEF P and its restructure, contentious issues were developed almost along the line of different perceptions of the Bank between its developed and developing country members. The negotiation of GEF P was concluded mainly between and among the donors and the Bank, which reminds us of the negotiation history of the IBRD that mainly took place between the developed countries. In addition, the formal power to determine GEF P policy or to approve GEF P projects remained the responsibilities of the World Bank (Werksman, 1995). It is, thus, not difficult to understand why the perception of GEF P have been as adversarial as that of the Bank in the eyes of developing countries and why they have argued for a new funding mechanism separate from the Bank⁶⁷.

⁶⁵ More discussion on the issues of “mainstreaming” will be conducted in Chapter 5.4.2.1.

⁶⁶ The experiences of the Bank as one of the implementing agency of the Multilateral Fund of the Montreal Protocol can be said to have witnessed this shift to a new role. However, the involvement of the Bank in the Multilateral Fund in terms of the negotiation process and decision-making process is not as extensive as that in GEF P.

⁶⁷ Literature abounds regarding the positions of developed and developing countries in the negotiation of the FCCC and whether GEF was to serve as the financial mechanism of the Convention. See, for example, Hyder, 1992; and Nitze, 1994.

For the same reason, the donor countries, sensing the similarities between GEF P and the Bank, preferred GEF P to act as the financial mechanism to several Rio documents, including the FCCC, because they felt they could have more control over the financial mechanism operated by the Bank, a financial institution whose decision-making procedure has been more favoured by developed countries⁶⁸. As a result, although it was GEF P that has been subject to keen debate as to whether it should serve as the Convention's financial mechanism, it was actually the role of the Bank, including its BW-style governance structure⁶⁹, that has been under scrutiny.

A compromise was reached at the end of the FCCC negotiation where GEF was accepted as the Convention's financial mechanism on an interim basis, and on the condition that it would be "appropriately restructured and its membership made universal to enable it to fulfil" the Convention's requirements (FCCC, Article 21.3). This final compromise and the subsequent structure of GEF I following the restructure should shed some light on the Bank in respect to its relationship with developing country members. The fundamental concerns of the developing countries include the governance structure of the Bank and how the resulting asymmetry problem might flow to the new financial mechanism of the FCCC if GEF P was to serve as that mechanism. With the increasing bargaining power of the developing countries in the negotiation of international environmental problems⁷⁰, developing countries were able to air their dissatisfaction of

⁶⁸ For example, as one commentator notes, the role of the UN ECOSOC was played down by the rich countries in comparison with the World Bank and the IMF, and part of the reasons for Western preference for the BWIs over ECOSOC "was its decision-making procedures" (Dasgupta, B, 1998, pp. 72–73.)

⁶⁹ As one commentator puts it "... the struggle was argued in terms of legitimacy versus efficiency." (Sjoberg, 1996, p. 156). Legitimacy is associated with universality, democratic decision-making and transparency while efficiency usually refers to cost-effectiveness, efficient management and operational criteria. These two sets of principles corresponded to different governance models: UN-style as legitimate and BW-style as effective.

⁷⁰ International environmental problems such as climate change require an international solution. Without the participation of the developing countries, unilateral efforts by the developed countries are certain to

the Bank and to secure a compromise in the end. The governance structure of GEF I no longer follows the Bretton Woods style weighted-voting system. A closer link has been instituted between GEF and the FCCC, in which the COP to the FCCC is bestowed with the authority to decide a major part of GEF operations, as the preceding section illustrated.

All these improvements could have deep ramifications for the World Bank in the context of re-evaluating its relation with the developing countries. On the other hand, to the extent that the developed countries and the Bank itself endorsed the structure of GEF I, it might have suggested a degree of tolerance within the Bank and the donors in terms of their willingness to accommodate the demand of governance structure reform from the developing countries. Under the circumstances, the structure of GEF I can provide a good model for the future reform within the Bank when dealing with the governance structure reform⁷¹. Furthermore, the Bank can better assist the implementation of the FCCC by its developing countries through its involvement in GEF as one of the IAs and as the Trustee of the GEF Trust Fund⁷², as the following investigation will reveal.

In addition to the significant implication of the outcome of GEF negotiation, another important ramification for the World Bank in the operation of GEF is the Bank's role as the Trustee of the GEF Trust Fund. GET and OTF were established under the Bank's Resolution 91-5 to be a part of GEF P (Resolution 91-5, para. 2-4, 16-18). After the restructure, a new the GEF Trust Fund was established under the GEF Instrument to

fail. The potential "ability" of the developing countries to undermine the success of the MEAs becomes a source of leverage and bargaining power for the developing countries (Hurrell and Kingsbury, 1992).

⁷¹ It needs to be noted that calls for reforming decision-making procedures of the BWIs have been placed as early as in the NIEO period in the 1970s and no actions have been taken within the BWIs two decades later. The governance of GEF I no doubt serves a theoretical model if the Bank decides to take up governance structure reform. Nevertheless, whether the reform can be materialised is another matter and the discussion of which is outside the scope of the present study.

replace the GET in GEF P (GEF Instrument, para. 8 and Annex B). The Bank is the Trustee of both trust funds. It was pointed out in Chapter 2 that the Bank had established a trust fund as early as in 1960 and had hosted more than 1,500 trust funds established by agreements between the Bank and the donors. Setting up trusts becomes one of the legal mechanisms whereby the Bank could be more flexible in its operations that might go beyond what have been prescribed in its Articles of Agreement. The Bank has fiduciary responsibilities as the trustee of these funds. In addition to the applicable provisions of the GEF Instrument, the Bank as Trustee to the GEF Trust Fund also needed to comply with the applicable provisions of its Articles of Agreement, by-laws, rules and decisions when administering the GEF Trust Fund. For example, projects funded by GEF can be subject to the competence of the Bank's Inspection Panel (Shihata, 1994b) as well as most of its operational procedures regarding environmental practices. From this perspective, one can argue that the concept of a "trust" is really not as innovative as one would have liked and some of the flaws in the operations of the Bank could be passed on to GEF when the GEF Trust Fund is administered by the Bank⁷³.

However, the Bank is subject to certain legal constraints when acting as the Trustee of the GEF Trust Fund, thereby restricting it when it carries out its regular operations. Firstly, after the restructuring of GEF, the Bank, as Trustee of the GEF Trust Fund, is accountable to the Council, which has a balanced representation from the

⁷² For example, "mainstreaming" the normal lending operation of the Bank has been one positive by-product the Bank and the environmentalists hope to see from the Bank's involvement in GEF (World Bank, March 1995).

⁷³ A good example would be to compare the exceptionally quick approving and disbursement process of GEF P with the "pressure to lend" staff culture of the Bank as has been identified in the Wapenhans Report (Wapenhans et al, 1992). The Wapenhans Report criticised that the Bank staff are usually under pressure to lend, in order to meet the desirable "targets" expressed in the volume of money lent, and, as a result, that the qualities of Bank loans can sometimes be sacrificed. Under GEF P, it is unclear whether the unusually quick process of proving grants has been resulted from Bank staffs working on GEF P grants under similar pressure to disburse GEF money quickly. In any case, the possibility remains.

developed and developing countries⁷⁴ for the performance of its fiduciary responsibilities (GEF Instrument, Annex B, para. 2). In addition, if inconsistency arises between the decisions of the Council and the rules of the Trustee (the Bank), the Council and the Trustee shall consult each other with a view to avoiding that inconsistency (GEF Instrument, Annex B, para. 12). Therefore, the operations of GEF, or any other trust funds the Bank is contemplating to establish for similar purposes to those for GEF⁷⁵, might be less affected by some of the Bank's practices that have been under criticisms from, for example, environmental NGOs.

In addition, the fact that the GEF Trust Fund could be set up by the Bank in the first place indicates that the Bank might begin to re-think the promotion of the traditional development model that fails to take physical environmental factors into account. According to the Bank's OP 14.40 of February 1997 on Trust Funds, the Bank does not accept Trust Funds that may present a conflict of interest⁷⁶ (OP 14.40, para. 4). If the Bank has not recognised the merit of sustainable development, it would not be able to accept the GEF Trust Fund that is to be established at the Bank. For example, the prospect of "mainstreaming" the Bank's operations through its participation in GEF reflects a crucial aspect of designing climate change policies: global environmental externalities should be internalised in national economic and sector development policies and programmes (World Bank, March 1995).

The main purpose of GEF is to assist developing countries to implement MEAs such as the FCCC. As a result, through acting as a Trustee of the GEF Trust Fund and as

⁷⁴ The Council consists of 32 members, of which 16 shall be from developing countries, 14 shall come from developed countries and 2 from the economies in transition (GEF Instrument, para. 16).

⁷⁵ For example, the Bank is now exploring the possibility of a Prototype Carbon Fund to create a market for carbon trading. See Chapter 4.1.2 for further discussion.

⁷⁶ Operations that have certain "conflict of interests" with the Bank can be interpreted as including operations that are incompatible with the Articles of Agreement of the IBRD.

a GEF IA, the Bank has been able to explore its new role of assisting the implementation of MEAs in its developing country members. Whether the Bank and GEF can play this new role effectively is, however, a different matter and will be examined in succeeding sections. GEF has developed closer links with the FCCC. Nonetheless, the role of the Bank in GEF operations remains instrumental and the regular operations of the Bank might influence GEF operations as a result. As discussed in Chapter 3, the application of conditionality and policy-based lending have been regarded as powerful tools of the SAPs employed by the BWIs to influence developing countries and have been, to a certain extent, effective at influencing developing countries. The next section will attempt to identify whether these legal and quasi-legal instruments associated with the SAPs have begun to develop in GEF operations in order to determine whether the Bank and GEF can play their new role effectively.

4.3 GEF: similarity with the SAPs

4.3.1 Programme and policy-based lending

4.3.1.1 GEF

Unlike the IBRD's Articles of Agreement, which provide that "loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific *projects* of reconstruction or development" (emphasis added) (Article III Section 4[vii]), the World Bank Resolution 91-5 did not specify the conditions upon which GEF P may provide funding. It seems, judging from the references made in all the documentation, to have assumed that the funding would be for specific projects. The operations of GEF P, which concerned only projects, have verified this assumption. In GEF I, however, provisions in the GEF Instrument refer to both *programmes* and

projects (GEF Instrument, para. 4)⁷⁷. It is unclear whether the negotiators of this particular language had in mind the experiences of the Bank's involvement in programme lending in early 1980s⁷⁸. In addition to the references in the GEF Instrument, Article 4.1 of the FCCC also determines the scope of GEF financing as GEF is designated as the interim financial mechanism of the FCCC. Article 4.1(b) stipulates that all Parties shall "formulate, implement, publish and regularly update *national and, where appropriate, regional programmes* containing measures to mitigate climate change" (emphasis added). It is anticipated, hence, that GEF will be called upon to finance the agreed full incremental costs of such "national or regional programmes" undertaken by developing country Parties to the FCCC. Consequently, unlike the IBRD, GEF is free from legal constraints to undertake funding other than for specific projects.

As of October 1998, all the money committed until FY 1998 were for specific projects. However, this does not preclude GEF I from engaging in programme-type funding in its later operations. Further investigations should be made by examining the operational strategy that serves as a "road map" guiding its actions. The the GEF Council approved the Operational Strategy at its meeting in October 1995 (GEF, February 1996) setting out the broad strategic considerations and the programming of GEF⁷⁹ operations. In view of the initial limited resources of GEF and the finite capacities of recipient countries and of the IAs, the Operational Strategy indicates that GEF operations will be programmed in three broad, interrelated categories: operational programmes, enabling

⁷⁷ Para. 4 of GEF Instrument provides that: "The GEF ... shall fund programmes and projects which are country driven and based on national priorities designed to support sustainable development and shall maintain sufficient flexibility to respond to changing circumstances in order to achieve its purposes."

⁷⁸ For the discussion of why the World Bank decided to involve itself in programme-type lending in late 1970s and early 1980s, and the relevant operations of the SALs and SECALs, the two most important programme lending, see Chapter 3.2.

⁷⁹ Since the discussion follows will concentrate on the operations of GEF I, the term "GEF" will be referring to GEF I unless otherwise indicated.

activities and short-term response measures. An operational programme is “a conceptual and planning framework for the design, implementation, and coordination of a set of projects to achieve a global environmental objective in a particular focal area”. Enabling activities, including inventories, compilation of information, policy analysis, and strategies and action plans, refer to “a basic building block of GEF assistance to countries”. Short-term response measures include projects that would “yield short-term benefits at a low cost” (GEF, February 1996). Among the three types of GEF operations designated in the Operational Strategy, Operational Programme provides an interesting insight as to the future direction of GEF funding.

On the basis of guidance from the two Conventions, of extensive consultations, and of technical and scientific review, 10 initial operational programmes in the focal area of biodiversity, climate change, and international waters are proposed in the Operational Strategy (GEF, February, 1996)⁸⁰. The development and implementation of projects in recipient countries are required to meet the objectives of operational programmes developed in each operational programme. For climate change, three initial Operational Programmes have been identified: removing barriers to energy conservation and energy efficiency (OP No. 5), promoting the adoption of renewable energy by removing barriers and reducing implementation costs (OP No. 6), and, reducing the long-term costs of low GHG-emitting energy technologies (OP No. 7) (GEF, June 1997)⁸¹. These three programmes were adopted on the basis of the recommendations of the Scientific and

⁸⁰ There is no operational programme for the focal area of ozone layer depletion. Activities in this focal area will be focused on short-term response measures and enabling activities consistent with the Montreal Protocol (GEF, February 1996). The Multilateral Fund of the Montreal Protocol provides funding for projects in this focal area.

⁸¹ The development of operational programme is an ongoing process, in which the Council, the two Conventions, and STAP will provide important guidance.

Technical Advisory Panel (STAP)⁸². The emphasis, according to the Operational Strategy, will be two-pronged. Firstly, to remove barriers to implementation of climate friendly, commercially viable technologies and secondly, to reduce the cost of prospective technologies that are not yet commercially viable, in order to enhance their commercial viability (GEF, February 1996).

The Operational Programme per se does not receive GEF funding. It refers to a conceptual framework in which a set of projects will be designed, implemented and coordinated to achieve a global environmental objective in any of the focal areas. In the case of climate change, the largest share of GEF climate change portfolio will go to long-term measures, which will be prepared in the context of operational programmes (GEF, February 1996). The three initial Operational Programmes concentrate mainly on removing implementation barriers for technologies and reducing the costs of promising technologies. In other words, the Operational Programmes seek to create an environment in which specific projects eligible for GEF funding can be carried out more efficiently and successfully — an environment in which the macroeconomic and policy situation are such that allows and encourages fair competition for the removal of barriers. The rationale behind these Operational Programmes recalls the socio-economic background in late 1970s when the implementation of the World Bank projects were so severely hampered by the macroeconomic environment in the member states that the Bank decided to undertake programme and policy-based lending to create an environment in which its projects could be implemented more efficiently⁸³. In other words, a policy-

⁸² STAP was formed under the guidance of the UNEP in response to GEF P participants' request that outside expertise be used to guarantee the scientific and technical qualities of GEF P operations. STAP continues to operate in GEF I according to GEF Instrument (para. 24), with the UNEP continuing to provide the STAP's Secretariat. Its role has been handicapped due to the lack of full-time professional staff (Reed, 1991).

⁸³ For a detailed discussion of World Bank's adjustment lending, see Chapter 3.2.

driven project will not succeed unless it is developed within the appropriate policy framework.

Prior to the experience of GEF I, the Multilateral Fund of the Montreal Protocol has, to some extent, already shown similar development toward a programme-oriented, though much narrower, operation. In the funding for developing country report, the Multilateral Fund provides a programme-type financing without the restrictions usually associated with this particular type of financing, such as conditionality in adjustment lending. In the case of Multilateral Fund, although funding is still approved and disbursed on a project basis, the approach the Multilateral Fund adopted in this type of financing is less fragmented than traditional lending decisions in the financing of specific projects (Patlis, 1992).

Even with the experience of the Multilateral Fund, it is difficult to identify a general trend moving from project to programme lending in the funding activities for achieving global environmental benefit. In the case of GEF, it remains unclear whether the drafters of these Operational Programmes had in mind the previous World Bank experiences when this fabric of GEF operations is laid down. The same ambiguity goes to the statement that GEF will start, or has started, the type of lending operation similar to adjustment lending of the BWIs in terms of targeting the macroeconomic policy framework. However, the rationale is indeed similar when it comes to the idea of providing a macroeconomic and policy environment conducive enough to facilitate project implementations. The following section will continue this discussion in more detail.

4.3.1.2 Comparison with the SAPs

As the preceding section indicated, the Operational Programmes per se are not eligible for GEF⁸⁴ funding. Hence, the present funding activities of GEF are not directly comparable with the adjustment lending of the BWIs. In addition, GEF provides most of its resources in the form of a “grant”, which does not require repayment as in the case of an adjustment “loan”. In addition, the “policy content”, an important feature of programme and policy-based lending, embedded in the adjustment lending has not yet emerged in the GEF operation. Nevertheless, the whole idea of GEF and the rationale behind the recent development of its funding activities bear some resemblance to the idea of adjustment lending in the BWIs.

With respect to institutions, similarities as well as differences can be identified between the BWIs and GEF, which are illustrated in Table 4–1. In terms of funding activities, the comparison between structural adjustment lending and GEF funding activities can also be drawn and will be illustrated in Table 4–2.

Table 4–1: Institutional comparison between the BWIs and GEF

INSTITUTIONAL- WISE	BWIS	GEF
Similarities	Both are established on initiatives from developed countries: the architects for the BWIs are US and UK, and GEF came from a French proposal.	
	Both are established to safeguard “global” interests: economic stability for the BWIs and environmental protection for GEF.	
	Both have weighted-voting system: the BWIs is based on quotas and GEF partially adopted similar principle of weighted voting.	

⁸⁴ In the following discussion, the term “GEF” will refer to both GEF P and GEF I; while “GEF P” and “GEF I” will be used respectively when references are made to the pilot phase and the restructured GEF.

Differences	BWIs are international institutions with full legal personality.	GEF P was not an international institution; the legal capacity of GEF I is still in doubt (Werksmans, 1993b and 1995).
	Board of Governors as the supreme decision-making body.	GEF Assembly as the supreme decision-making body, but is to receive guidance from the FCCC and CBD ⁸⁵ .

Table 4-2: Comparison between funding activities of the BWIs and GEF

FUNDING ACTIVITIES	STRUCTURAL ADJUSTMENT LENDING	GEF LENDING AND GRANTS
Similarities	World Bank involvement: either as a major source of lender (in the case of the SA lending) or as an IA (in the case of GEF grant).	
	Programme and policy-based lending: SAL/SECAL from the Bank and ESAF form the Fund, Operational Programmes in GEF operation.	
Differences	Direct funding goes to non-project, policy-based lending.	Directing funding goes to specific projects.
	Loans are disbursed in several tranches in each loan.	Loans are disbursed in full in each project.

Some relevant issues can be observed from these two tables. Firstly, the weighted-voting system of the BWIs that is based exclusively on financial contribution has been mitigated in GEF I. A double-majority system that takes into account individual country’s vote was adopted by the GEF Council. In addition, the two COPs to the MEAs are charged with deciding on the policies, programme priorities and eligibility criteria in the focal areas of climate change and biodiversity of GEF operations. This results in the differences between the BWIs and GEF I in terms of governance structure. This

⁸⁵ Guidance is given by the two COPs in the areas of climate change and biodiversity. However, for the other two areas where GEF has the sole responsibility to reach decisions, policies can not contradict with the guidance from the two COPs. For further discussion, see Chapter 4.2.2.

difference might bring an impact on the operations of the World Bank, as we shall see in the succeeding section.

Secondly, although not directly comparable, the programme and policy-based lending operations, in terms of its aim to seek policy change, can be found in both GEF funding activities and the adjustment lending of the BWIs. The structural adjustment lending of the BWIs seeks to correct the macroeconomic and policy framework in which other regular activities of the BWIs and the borrowing government operate. The Operational Programmes, as identified in the Operational Strategies, of GEF I envisaged an environment in which GEF projects could be implemented more effectively and successfully, and attempted to gear GEF operations toward achieving such a conducive environment. However, as seen from Table 4–2, money provided by GEF is still used for the purpose of specific projects, while adjustment loans are for the purpose of promoting policy changes. Nevertheless, the provisions laid down in the GEF Instrument do not bar such “programmes” from being eligible for future GEF funding (GEF Instrument, para. 4).

Lastly, the differences between adjustment loans and GEF grants in the process of disbursement will affect the issue of “conditionality,” one of the biggest controversies in adjustment lending. Since tranching policy reinforces the application of conditionality, it might be tempted to conclude that the issue of conditionality does not exist in GEF operation since disbursement does not depend on borrower’s fulfilment of the conditions laid down by GEF. Is this really the case? The following discussion will explore the issue of conditionality in more detail.

4.3.2 Conditionality

4.3.2.1 GEF

As indicated, the disbursement of GEF funding is not divided into several tranches. It has been, hence, suggested that the controversies surrounding “conditionality” does not exist in the operations of GEF⁸⁶. However, conditionalities are associated not only with the disbursement process, but also with the wider environment in which a loan is identified, approved, implemented, and monitored⁸⁷. In fact, conditionality refers to the exchange of financial assistance for policy reform. The disbursement process and tranching policy are only means to reinforce the “effect” of conditionality, namely, to ensure that the money provided is for genuine policy reform. The forms of conditionalities associated with GEF might differ from those with the BWIs. The consequences of not complying with conditionalities in the context of the BWIs might carry different degrees of legal implications from those in the case of GEF operations⁸⁸. Nevertheless, conditionalities might begin to develop in the operations of GEF, as the following discussion will demonstrate.

At the stage of pre-approval, a potential recipient of GEF grant needs to comply with two sets of eligibility. In terms of country eligibility, only “countries that are Parties to the Convention”, which refers to developing country Parties to the FCCC, are eligible

⁸⁶ During the negotiation of the financial chapter in Agenda 21, conditionality, applied in the form of the “tranching policy” in the case of GEF, proved to be the thorniest issue. The G-77 countries would not accept the attachment of conditionalities to loans. In the end, the issue of conditionality in GEF section had a rather easy solution with the unanimous acceptance of the expression used in Resolution 44/228: “... without introducing any new forms of conditionality” (Ricupero, 1993). However, as we shall see later, this does not bar the subsequent practice of GEF in developing conditionality in various forms.

⁸⁷ In the context of the IMF operations, conditionalities refer to the pragmatic and flexible body of policies and programmes approved by the Fund for assisting its member to overcome the balance of payments difficulties (Guitian, 1981). It is mostly within the context of the World Bank’s SAL/SECAL operations that conditionalities are applied in the disbursement process.

⁸⁸ The legal implications of “violating” conditionalities in the BWIs are discussed on the operational and legal aspect of the SAP in Chapter 3.2.2 and 3.2.3.

to apply to GEF funding for climate change-related projects⁸⁹. In terms of project eligibility, the following conditions will need to be met. Firstly, an eligible GEF project must carry with it the “agreed global environmental benefit”, as stipulated in para. 2 of the GEF Instrument. Secondly, a project must comply with the guidance from the COP to the FCCC, as stipulated in Article 11.1 of the Convention and para. 26 of the GEF Instrument. Thirdly, an eligible project needs to comply with the measures and activities enumerated in the Operational Strategy. Lastly, the proposed project must fall within one of the three Operational Programmes in the focal area of climate change identified in the Operational Strategy (OP No. 5–7). In addition to these substantive conditions, certain procedural requirements must be followed in the preparation of submitting a project⁹⁰. These conditions, however, do not seem to be directly comparable to the so-called pre-conditionalities, ie the type of conditionality applied prior to an adjustment lending of the BWIs. The pre-conditions required in the adjustment lending usually entail certain policy changes to be undertaken by the borrowing government; while the eligibility conditions do not have such requirement on the part of the recipient governments.

These conditions relating to eligibility are not the type of pre-conditions as applied in the adjustment loans. However, the possibility of similar type of conditionality cannot be ruled out. In the independent evaluation report on the first three years of GEF I, the evaluation team noted that: “macroeconomic or sectoral policies and economic activities may undermine GEF projects ...” (GEF, March 1998, para. 181). The team found that IAs, including the World Bank, have generally identified policy issues or sectoral activity that could pose significant risks to the project in the project document.

⁸⁹ For the guidance from the COP in relation to country eligibility, see Decision 11/CP.1, FCCC/CP/1995/7/Add.1: “Initial guidance on policies, programme, priorities and eligibility criteria to the operating entity or entities of the financial mechanism.” (Para. 1[c][I].)

The IAs have raised the issues with the recipient governments during project design. The team recommends that: “GEF should adopt a policy requiring that Implementing Agencies obtain *clear, formal commitments from recipient country governments* regarding *policies and sectoral activities* identified as increasing the risk of project failure *before* proceeding with project implementation.” (emphasis added.) (GEF, March 1998, para. 193.) What the finding of this evaluation report shows is that GEF has started to concern itself with the policy framework in which its projects will operate *before* such project is included and has attempted to raise such issues with the recipient governments. Furthermore, the report recommends that formal commitment should be obtained from the recipient government to change its policy framework that could undermine GEF projects.

At the GEF Council Meeting following the publication of this GEF evaluation report, a report was adopted relating to the actions taken or considered to take in responding to the recommendations proposed in GEF evaluation report. In relation to the recommendation that seeks to improve the policies environment in the recipient countries, the GEF Secretariat reports that it will “request the Implementing Agencies to facilitate this review process by making explicit reference in the project briefs to ‘specific policies or sectoral economic activities that could negatively affect project success’” (GEF, September 1998, p. 9). Although the GEF Council does not yet decide to seek formal commitment from the recipient government to change its policy framework, the implication of this action taken by the GEF Secretariat means that the World Bank as one of the IAs can look into the policy framework of GEF recipient countries by ways of this review process. If GEF in the future decides take up such

⁹⁰ See, for example, the “operational guidance for the preparation and approval of medium-sized projects,”

recommendation as to seeking formal commitment from the recipient governments in this aspect, it will then begin to practice the type of “pre-conditionality” as those applied in the adjustment lending of the BWIs.

After a project is approved by the GEF Council, conditionality is not applied in the same manner as in the context of disbursement process of an adjustment loan since the disbursement of GEF funding for the project is not divided into several tranches. The “post-approval conditionality” in GEF operations takes a slightly different form from that in the BWIs. Instead of setting out conditions to be complied in one single loan, the post-approval conditionality of GEF appears in a series of projects, proposed either by GEF or by the recipient government, under one Operational Programme. In other words, the preparation and approval of a subsequent project, which falls within the same Operational Programme as the previously one, is contingent upon the fulfilment of certain conditions by the recipient government. Two examples will be discussed as an illustration: one relates to a series of ozone grants to Russia in 1995 and the other relates to two energy conservation grants to China in 1996.

The purpose of a series of ozone grants is to provide financial assistance to Russia to comply with its obligations under the Montreal Protocol. The non-compliance of the Montreal Protocol by Russia is considered and decided by the Montreal Protocol Implementation Committee. However, the GEF Council has played an important role in pressing for Russia’s implementation of the decisions of the Montreal Protocol Implementation Committee and the Meeting of the Parties⁹¹. The co-operation between the Implementation Committee and the GEF Council has allowed conditionality to arise. In order to assist Russia to comply with its obligations under the Montreal Protocol, the

and “medium-sized project brief,” both can be found at GEF website at: <http://www.gefweb.com>

GEF Council has designed a series of projects divided into three separate tranches⁹² to be released only upon the fulfilment of specified conditions. The first tranche of GEF grant to Russia under its ozone programme with the amount of US\$ 8.6m was approved by the Council in 1995. The second tranche of funds is approved on the condition that GEF's Chief Executive Officer "has received confirmation from the Ozone Secretariat that it has received satisfactory responses to the queries posed by the Implementation Committee of the Montreal Protocol to the Russia Federation" (Joint Summary of the Chairs, the GEF Council Meeting, 2–4 April 1996; GEF/C7/3: World Programme Proposed for Council Approval).

The second example concerns one particular project in the Work Programme Proposals of 31 March 1997 for the GEF Council approval (GEF/C9/3). The Chief Executive Officer⁹³ recommended to the Council, for its consideration and approval, a proposed work programme containing 21 projects at the GEF Council Meeting⁹⁴ during 30 April to 1 May 1997 (GEF, 31 March 1997a). In this Work Programme Proposal, similar type of post-approval conditionality is identified in the project financing of Project B–16 on Energy Conservation in China. Project B–16 is to "achieve large, sustained and growing increases in energy efficiency, and associated reductions in the rate of growth in carbon dioxide emissions and other pollutants, through the introduction, demonstration, and dissemination of new project financing concepts and the establishment of Energy Management Companies to promote energy efficiency measure

⁹¹ For a detailed discussion of Russia's non-compliance and the Montreal Protocol, see Werksman, 1996b:

⁹² The term "tranche" used here is different from the one used in the adjustment loans of the BWIs. It refers to different GEF projects (grants) rather than instalments within one loan.

⁹³ The position of the CEO was created in GEF I. The CEO heads the GEF Secretariat and is to be appointed to serve for three years on a full time basis. The CEO is responsible for the organisation, appointment and dismissal of Secretariat staff and is accountable for the performance of the Secretariat functions to the Council (GEF Instrument, para. 21).

in China.” (GEF, 31 March 1997a.) This project complies with the objectives of OP No. 5⁹⁵ is to be executed by the World Bank, and complements other GEF projects⁹⁶ addressing the same set of barriers to energy conservation in China. It should be pointed out from the outset that GEF funding for this particular project, as described in the “project information document” would be disbursed in full once the project is approved by the GEF Council. Nevertheless, a possible subsequent GEF grant is proposed as well. It is stated in the project information documents that: “GEF financing for the project will be sought in *two tranches*. The first tranche includes GEF financing support for Phase I components ... A second tranche of GEF financing, *the size of which will be determined during implementation of Phase I*, will be sought for the Phase II Expansion Component.” (emphasis added.) (GEF, 31 March 1997b.) The conditions for submission of the Phase II request to the GEF Council are also delineated in the same document. In addition, key performance indicators for all components⁹⁷, as well as key indicators in evaluating Phase I results before the submission of a Phase II request to the GEF Council, are specified.

4.3.2.2 Comparison with the SAPs

This type of “phasing” of a GEF grant does not amount to “conditionality” requirements as in the case of adjustment lending of the BWIs. Though the legal implication of conditionality in adjustment lending is ambiguous, one of the practical implications is that it affects the disbursement of the next tranche of an adjustment loan.

⁹⁴ The Council is to meet semi-annually or as frequently as necessary at the seat of the Secretariat, which is located in Washington DC (GEF Instrument, para. 17).

⁹⁵ Operational Programme No. 5 is the removal of barriers to energy conservation and energy efficiency.

⁹⁶ These projects include two UNDP-implemented technical assistance projects and two World Bank-implemented investment projects (GEF, 31 March 1997b).

In the two examples of the types of post-approval conditionality in GEF operations, the “second tranche” refers to the funding of a future project that is not yet prepared by GEF, rather than to the second disbursement of the same project. As a result, the recipient governments, ie the Russian and the Chinese governments in these cases, could, theoretically, afford to ignore the conditions on which the “second tranche” depends without affecting the full disbursement of the present project⁹⁸. The consequence of this conditionality “violation” is indeed very different from the scenario of that in the adjustment lending. However, similarity between them can be identified if consideration is taken from a broader perspective to look at the Operational Programme⁹⁹ in which these projects are to operate. The purpose of setting down conditions on which subsequent GEF funding depends is to ensure the continuity of the projects in order to achieve the objectives of the Operational Programmes. In the case of adjustment lending in the BWIs, one of the purposes of conditionality is to ensure the objectives of an adjustment loan will be achieved. Therefore, the phasing of proposed GEF grants shares the same rationale with the compliance of conditionality in the adjustment lending.

The GEF projects in the focal area of climate change needs to fall within any of the three Operational Programmes, which seeks to create an environment in which

⁹⁷ These key performance indicators will include institutional performance indicators as well as quantified energy savings and associated CO₂ emission reduction resulting from the project (GEF, 31 March 1997b).

⁹⁸ The consequences of not complying with the conditions might have more legal, or practical, implications in the Russian case since it involves other legal obligations undertaken by the Russia under the Montreal Protocol, see Werksman, 1996b.

⁹⁹ There is no operational programme for the focal area concerning ozone layer depletion and GEF is not linked formally to the Montreal Protocol. However, GEF Operational Strategy in ozone depletion is “an operational response to the Montreal Protocol, its amendment, and adjustment” (GEF, February 1996). In addition, the series of the ozone grants to Russia are for the specific purpose of providing financial assistance for Russian compliance with the Montreal Protocol. Therefore, although not directly comparable with China’s energy conservation projects, which fall under one Operational Programme, the conditionality applied in the ozone grants to Russia also serves the purpose of consistency and continuity to ensure the compliance of Montreal Protocol by its parties. The comparison might be easier to identify if “compliance with the Montreal Protocol” were regarded as another Operational Programme designed by the GEF Council.

projects can be successfully implemented. In other words, in order to ensure the successful implementation of a GEF project, the recipient government will have to provide such an environment, which usually entails a change of policy framework in most of the developing countries. By conditioning the subsequent projects on the implementation of the first project, it seems that GEF implicitly seeks to encourage the recipient government to change its policy framework in order to provide an environment conducive enough for successful implementation of the first and subsequent projects. From this perspective, conditionality, defined as “the exchange of financial assistance for policy reform” seems to have begun to develop in GEF operations.

Conditionalities are imposed on the recipient countries, which are the developing country Parties to the FCCC in the case of GEF serving as the entity entrusted by the COP to operate the financial mechanism. In the context of the FCCC, it is worth noting that another form of condition is imposed on the *developed country Parties*, which represent donors in GEF. Article 4.7 of the FCCC stipulates that: “The extent to which developing country Parties will effectively implement their commitments under the Convention will *depend on* the effective implementation by developed country Parties of their commitments under the Convention related to financial resources and transfer of technology ...” (emphasis added.) Namely, the Convention places a condition on the developed country parties to implement their obligations relating to financial resources and transfer of technology as a prerequisite for developing country Parties to implement their treaty obligations. This form of conditionality — an “inverse” conditionality¹⁰⁰ —

¹⁰⁰ The choice of the word “conditionality” might not be appropriate considering what conditionality stands for in the practice of the BWIs. Article 4.7 of the FCCC does not seek a complete policy change in the developed countries. It merely sets down a “condition” for its developed country Parties to implement if co-operation from the developing country Parties are anticipated. However, this is still phenomenal as developed countries are required under an international treaty to take responsibilities to solve problems to which they have contributed most in the past.

injects a new dimension into the traditional relationship between donors and recipients in the BWIs regarding conditionality. This “inverse conditionality” has, arguably, more legal implications than conventional conditionality since failure to comply could constitute a legitimate defence for developing country Parties’ non-compliance. How this phenomenon is reflected in the operations of GEF has not yet been ascertained, as corresponding provisions are nowhere to be found in the guidance from the COP to GEF. Nevertheless, this development merits closer and continuing observation for its potential implications on the relationship between the donors and recipients in the BWIs.

To conclude, the issue of conditionality, the “conventional” conditionality, seems to exist in GEF operations, albeit the term “conditionality” is not used. Considering the limited resources GEF has and, as a result, the limited projects GEF resources are able to finance¹⁰¹, it is conceivable that conditions in country and project eligibility are applied so rigorously. The similar consideration can be identified in, for example, the rationale behind the IMF conditionality in that its resources are available to its member states only temporarily¹⁰² and conditions need to be applied in order to ensure that its limited resources are used efficiently and that the same resources can be used by other member states. On the other hand, taken into account the rationale behind the design of the Operational Programmes, and the requirement that projects must comply with the purposes of one of the Operational Programmes, it is also understandable that post-approval conditionalities are applied in the manner as the two above-mentioned examples demonstrated. This consideration somewhat reminds us of the rationale behind the

¹⁰¹ In particular, GEF funding has been taken the form of “grant” so far. The financial resources are not “recycled” by repayments from the recipients, as are in the case of loans from the BWIs.

¹⁰² Article I(v) of the Articles of Agreement of the IMF states that: “The purpose of the IMF is ... to give confidence to members by making the general resources of the Fund *temporarily* available to them under *adequate safeguards*.” (emphasis added.)

structural adjustment lending of the World Bank¹⁰³. These forms of conditionalities employed by GEF might be different from the narrower concept of “conditionality” in the context of loan disbursement in the BWIs. Nevertheless, conditionality does exist and remains an important issue in GEF operations, as is in the case with the operations of the BWIs.

Before rounding off this section in which comparisons are drawn between GEF and the adjustment lending of the BWIs, it is to be noted that the “unit” of comparison is not always directly comparable between the two. For example, an *Operational Programme* designed by GEF, rather than a single GEF project (or grant) is the unit of comparison with an adjustment loan of the BWIs when the similar programmatic nature between the two are identified. Another example concerns the comparison between the post-approval conditionalities of GEF and conditionality employed in the disbursement process of the BWIs. The GEF form of conditionality involves *a series of projects (grants)* while the BWIs type of conditionality in a more confined sense applies to different tranches in *one single loan*. Furthermore, it needs to be noted that the relative size of the resources involved is different. Compared with the overall resources available in the World Bank and some of the larger adjustment loans, the resource GEF is able to provide is bound to be smaller than what the adjustment loan can provide¹⁰⁴. This, however, will not invalidate the purpose of conducting this comparison, which intends to demonstrate how a new mechanism like GEF, with a touch of similarity and a brand new institutional device, might be more effective for the World Bank to play an effective new

¹⁰³ See the Chapter 4.3.1.2 on the discussion of the comparison between GEF and programme-type adjustment lending.

¹⁰⁴ For example, a Coal Sector Adjustment Loan made by the IBRD to Russia in FY 1998 provided US\$ 800m and a SAL made to South Korea in the same year provided US\$ 3bn. In the case of GEF, the total resources available from 1998 to 2001 after the second round of replenishment negotiation is only

role in assisting the implementation of the FCCC in the developing countries. The following section will continue carrying on discussion in the context of relationship between the World Bank and developing countries.

4.4 Relationship between the Bank and developing countries in light of the innovative mechanisms

The governance structure of GEF, including its novel decision-making rules and closer link with the FCCC, has to a certain extent address the issue of asymmetry perceived by the developing countries in the traditional financial institutions like the BWIs. Within the GEF Council, developing countries have secured a voting procedure where the developed countries no longer control the majority voting power. In addition, through the relationship established by the GEF Instrument, the FCCC, and the MOU, the authority of the COP to the FCCC has been acknowledged over the major parts of GEF operations. This might be a positive development for the developing countries since the decision-making arrangement in the COP represents a more collective process where the needs and priorities of the developing countries have the opportunities to be incorporated. It seems plausible to conclude that, in the context of the novel governance structure of GEF, the overall relationship between GEF and the recipient countries has begun to improve compared with the traditional relationship between similar types of financial institutions, notably the BWIs, with their recipients. This improvement has ramifications as well on the relationship between the developing countries and the Bank as the Trustee of the GEF Trust Fund and as one of the IAs.

US\$ 2.57bn. The amount of resource provided by GEF grant stands no comparison with that provided by the IBRD.

In addition to the novel governance structure, another aspect of GEF operation has equally important implications for the World Bank and that is the possible move toward the adoption of conditionality and programme and policy-based lending. These legal and quasi-legal instruments have been employed by the BWIs to influence the developing countries in dealing with structural adjustment problems. As Chapter 3 come close to demonstrate, these legal and quasi-legal instruments associated with the SAPs of the BWIs have been rather effective in producing changes of domestic laws and policies, albeit their effectiveness in achieving the desirable result might have been undermined by the governance structure of the BWIs perceived as asymmetric by developing countries. The development in GEF operations towards the adoption of similar instruments might arguably give the World Bank more leverage in influencing their developing countries' policies to implement the FCCC. Furthermore, GEF, compared with the SAPs, might have a better chance at producing the desirable result, ie the *impact*, because its novel governance structure that might be able to mitigate the problem of asymmetry perceived by the developing countries.

As Chapter 3 pointed out, an important element in contributing to the implementation of the SAPs by the borrowing government is "ownership," and it was argued in that chapter that the tense relationship between the BWIs and the developing countries, resulting from the governance structure, reduced the intensity of borrower ownership. In the case of GEF, the novel governance structure has brought a closer relationship with the FCCC. The guidance from the COP to the FCCC shall be followed or respected in the operations of GEF, and the COP has the authority to decide on policies, programme priorities and eligibility criteria related to the FCCC. The developing countries can, via the forum of the COP, put into their environmental and

developmental priorities and participate in the process of drawing up the guidance to GEF. Under this arrangement, the ownership problem identified in the SAPs could be addressed since developing countries are able to participate in the decisions relating to GEF grants and funding. Thus, GEF projects and programmes might overcome the hurdle of “borrower ownership” and get implemented by the recipient governments. As a result, the legal and quasi-legal instruments employed in GEF might be effective in producing both an *outcome* and an *impact* because of the novel governance structure of GEF that helps to improve relationship between the Bank and the recipient developing countries.

From the discussion in the preceding chapters, the evolution of the relationship between the BWIs and the developing countries can be analysed as follows. Before the 1990s, the BWIs tried to influence the developing country members to embark on the model of “development”, ie unlimited economic growth, that they perceived as ideal. With the introduction of structural adjustment lending in the 1980s, the BWIs have had a certain degree of success in producing an *outcome*, ie policy changes in the borrowing developing country. The main tools associated with the SAPs and employed by the BWIs in influencing the developing countries are programme and policy-based lending and the application of conditionality. However, as has been identified in Chapter 2, developing countries have been quite discontent with the governance structure and the consequent asymmetrical treatment they received in the operations of the BWIs. Furthermore, the asymmetry perceived by the developing countries, the more so in the context of conditionality and policy-based lending, might have itself weakened the sense of “borrower ownership” of the SAPs and, as a result, diminished the effectiveness in

producing an *impact*, ie delivering the desirable economic situation intended by the BWIs' own programmes in the borrowing developing countries.

Meanwhile, as the environmental impact of the traditional model of "development" became apparent to and recognised by the international community, the relationship between the BWIs and the developing countries has gone through a transformation as well. After the 1990s, World Bank began to introduce new mechanisms in which funding is provided to assist domestic compliance with MEAs in the developing countries members. In this new relationship, mostly demonstrated from the operations of GEF, the relationship between the World Bank and the developing countries has been gradually improving. The asymmetric treatment within the BWIs as perceived by the developing countries has somehow been mitigated by the novel governance structure in GEF, including the closer link between the COP to the FCCC and the World Bank in its capacity as both the Trustee of the GEF Trust Fund and one of the GEF's IAs.

When "development" was perceived as unlimited economic growth and was promoted by the BWIs, the relationship between the BWIs and the developing countries has been anything but harmonious. The main reasons are the governance structure of the BWIs and the mechanisms created thereof, the SAPs, to be employed by the BWIs to influence the development path of the borrowing developing countries. The legal and quasi-legal instruments employed by the SAPs, including policy-based lending and the application of conditionality, have provoked controversies as they are perceived by developing countries as part of the asymmetry in the BWIs. When sustainable development emerged and the World Bank began experimenting with innovative mechanisms as a response, the relationship between the Bank and the developing

countries had been undergoing certain transformation because of the nature and design of these new mechanisms¹⁰⁵. In the operations of GEF, policy-based lending and conditionality might begin to develop gradually, as identified in this chapter. Will this development effect the improved relationship between the World Bank and the developing countries for which the developing countries have fought very hard to achieve?

As one commentator puts it: “the usual critique of conditionality has focused on the nature of the conditions rather than on the principle of conditionality” (Collier et al, 1997, p. 1399). The uneasy feeling the developing countries has toward conditionality and policy-based lending is largely associated with the ways in which the conditions and policy advice are designed and imposed by the management and donors of the BWIs. It is the asymmetric treatment perceived by the developing countries within the BWIs, rather than the rationale behind conditionality and policy-based lending, that is the source of discontent¹⁰⁶. “Environmental conditionality” has been fiercely opposed to by the developing countries during the negotiation of the UNCED (Ricupero, 1993). It is, however, the environmental “conditionality”, conditionality associated with the BWIs¹⁰⁷, that is at the centre of controversy. The principle of “environmental” conditionality in the context of achieving a sustainable development is not disputed for the concept of sustainable development has been accepted and endorsed by the developing countries

¹⁰⁵ That is, the novel decision-making rules and the closer link with the MEAs. See Chapter 4.1 and 4.2 for a further discussion.

¹⁰⁶ In addition to the asymmetry resulted from the weighted voting system, another asymmetry is relating to the adjustment measures an indebted countries are required to adopt while richer creditor countries, especially those with a balance of payments surplus, are required to do nothing. This is another basic problem of the SAPs (Singer, 1995), which will not be dealt with in the present study due to the limited scope of thesis.

¹⁰⁷ As discussed in Chapter 4.1.2.1 the distrust the developing countries have toward GEF P was mainly the reflection of that toward the World Bank. As a result, what the developing countries did not want was the kind of environmental conditionality that is designed and imposed by the World Bank, as the traditional type of conditionality associated with the SAPs.

themselves at the UNCED¹⁰⁸. In addition, in the case of GEF, the decision-making process in which conditions and policies are decided is different from that in the operations of the SAPs and the BWIs. The World Bank, as the Trustee of the GEF Trust Fund and as one of the IAs, will need to follow the guidelines adopted in the COP to the FCCC, over which the developing countries can have more control. Therefore, the developing countries can take advantage of the more equitable decision-making structure of the GEF Council and of the FCCC COP, and contribute to the design of a set of conditions and policies that are beneficial to their own development as well as the global environment.

Moreover, as has been discussed in the preceding section, a kind of “inverse conditionality” has been incorporated in Article 4.7 of the FCCC. Conditions are imposed on the developed countries for what might be the first time if the developing countries are expected to implement their obligations under the FCCC. That resulted from the increasing bargaining power the developing countries are able to employ in negotiating international environmental affairs. With this newly gained bargaining power, developing countries no longer need to feel uneasy about the practice of programme lending and conditionality being developed in the operations of GEF. On the contrary, the developing countries can take advantages of their positions in the FCCC and put into the conditions and policies that are of more importance to them.

From the perspectives of the management, as well as the donors of the World Bank, the “new” conditionality associated with GEF strengthens its influence over the developing countries as well. With the practice of policy-based lending being developed in the operations of GEF, albeit in the context of operational programmes, the Bank will

¹⁰⁸ However, there is no consensus as to what “environmental” conditionality entails, for the concept and

be able to gain access to the policy-making process in the borrowing governments in areas other than economic policies¹⁰⁹. In addition, the effectiveness in producing both an *outcome* and an *impact* in the borrowing government is enhanced as well for the following reasons. GEF funding is to assist the developing country members in implementing the FCCC, an international treaty that imposes legal obligations upon its Parties. The borrowing countries are under legal obligations to change their domestic laws and policies to implement these laws and policies and to comply with the FCCC. Therefore, policy advice given and conditionality imposed through the operations of GEF will be able to encourage the borrowing governments a swifter change of laws and policies in order to implement the FCCC — producing an *outcome*. Under this circumstance, if conditionality and policy-based lending are beginning to develop in GEF, they will be more effective in producing an *impact*, ie an improved environmental state in which GHGs emissions are stabilised¹¹⁰ since the recipients will be willing to implement these policy changes because of two reasons. First, the recipients are Parties to the FCCC and are, thus, under treaty obligations to implement these laws and policies in any case. Secondly, and most importantly, because of a stronger sense of “ownership” the recipients might have toward the GEF projects. The reason for this improvement lies in the unique characteristics of GEF: its novel governance structure of decision-making rules and closer link with the FCCC. These unique characteristics of GEF serve to reduce

definition of “sustainable development” itself is undergoing debate and clarification.

¹⁰⁹ It is particularly the case now that the GEF Secretariat, as discussed in the previous section, will begin to request the IAs to put into explicit reference in the project briefs “specific policies or sectoral economic activities that could negatively affect project success”. For further discussion, see Chapter 4.3.2.1.

¹¹⁰ Confusion should not be made between two sets of parallel and theoretically comparable objectives of the SAPs and of GEF, which have implications in analysing the effectiveness in terms of producing an *impact*. The objective of the SAPs is mainly to improve the economic situation of the borrowing developing countries, while the aim of GEF is to assist the implementation of the FCCC in developing countries. Thus, the *impact* of an effective SAP will be an economic situation in which the countries’ balance of payments positions are improved, while the *impact* of an effective GEF grant will be an

the controversies surrounding “conditionalities”, in particular in the context of the governance structure of the BWIs and the resulting asymmetric treatment perceived by developing countries. These characteristics might also play a role in enhancing the sense of “ownership” developing countries have over GEF projects and grants and, as a result, produce the desirable *impact* as intended by GEF.

It is still too early to conclude whether the overall relationship between the World Bank and their developing country members have been improved greatly and the legal and quasi-legal instruments employed by the BWIs will be very effectively for the Bank to play its new role. Nonetheless, the new dimension of this relationship injected by GEF is a positive development after all. The following chapter will begin to discuss how the BWIs can use their influences to assist the implementation of the FCCC in their developing country members.

environmental situation in which the emissions of GHGs are stabilised to a satisfactory level in controlling climate change.

CHAPTER 5: FRAMEWORK CONVENTION ON CLIMATE CHANGE AND BRETTON WOODS INSTITUTIONS

In the previous chapters, we established that the BWIs and the legal and quasi-legal instruments employed to influence the developing countries achieved a certain degree of effectiveness. The subject of this chapter is whether they can exert such influence to assist the implementation of the FCCC in developing countries.

A brief account of the FCCC will be introduced from the outset. The relationship between the BWIs and the FCCC will be examined, including issues such as how treaty obligations under the FCCC can affect the regular operations of the BWIs, and implications of the Kyoto Protocol to the World Bank. The remaining two sections will examine the operations of the SAPs of the BWIs and the innovative mechanisms of the World Bank that might be relevant to the FCCC and the Kyoto Protocol. The third section first identifies the relationship between the SAPs and the environment, with particular reference to climate change, and proposes possible reforms of the SAPs in the light of the obligations under the FCCC. The last section will then conduct a brief evaluation of the innovative mechanisms of the World Bank, which are designed primarily to facilitate the implementation of the FCCC and the Kyoto Protocol.

5.1 The UNFCCC

Before examining the relationship between the BWIs and the FCCC, this section will firstly look at the Convention itself. A very brief account of the negotiation history leading to the Convention will be discussed. The Convention, the important decisions reached at the Conference of the Parties (COP) and the unique treaty obligations based

on the principle of common but differentiated responsibilities for its Parties, are also examined. The relevance of the FCCC with, in particular, the operations of the BWIs will be the emphasis at all times.

5.1.1 Negotiation history

The issue of climate change first reached the UN General Assembly in September 1988, with Malta proposing that climate should be recognised as “common heritage of mankind”. By December 1988, the General Assembly passed Resolution 43/53 recognising that climate change is “a common concern of mankind” and endorsing the establishment of an Intergovernmental Panel on Climate Change (IPCC) set up jointly by the UNEP and the World Meteorological Organisation (WMO). The IPCC was entrusted to “provide internationally coordinated scientific assessments of the magnitude, timing and potential environmental and socio-economic impact of climate change and realistic response strategies”. The FCCC was negotiated by an Intergovernmental Negotiating Committee on Climate Change (INC) established under the UN General Assembly Resolution 45/212 in December 1990¹, from 1990–92. Resolution 45/212 also establishes a special voluntary fund for developing countries to ensure their full and effective participation in the negotiating process (Zaelke and Cameron, 1990).

In addition to the IPCC and the INC, various international conferences, either at the initiative of individual states or sponsored by the UN and/or its specialised agencies,

¹ UN General Assembly Resolution 45/212 (21 December 1990) on the “Protection of global climate for present and future generations of mankind” decided “to establish a single intergovernmental negotiating process under the auspices of the General Assembly ... for the preparation by an INC of an effective framework convention on climate change, containing appropriate commitments, and any related instruments as might be agreed upon ...”

were held in the late 1980s and early 1990s². The 1990 Second World Climate Conference (SWCC) organised by the WMO in conjunction with other UN bodies and the International Council of Scientific Unions, marked an important development in the negotiation history of climate change. For the first time, developing countries participated as equal partners in the discussions and made clear, to a much greater extent than previously, that north–south issue would play a prominent role in any future convention negotiations (Bodansky, 1993 and 1994). One of the significant effects of that development was that, it became obvious that the climate change negotiation would not be simply about the environment, but about the inseparable issues of environment and development³.

In addition to the constant debate about environment and development, another contentious issue throughout the negotiation process has been the financial resources needed by developing countries to implement the Convention, ie the financial mechanism under the Convention. Prior to the first INC meeting, negotiation for the pilot phase GEF (GEF P) was concluded in November 1990. After the first INC meeting in February 1991, the first Participants' meeting of GEF P was held in April 1991. Throughout the INC negotiation process, GEF was favoured by the developed countries to act as the Convention's financial mechanism; while the developing countries remained

² For example, the 1988 Toronto Conference on the Changing Atmosphere, held by the Canadian government, adopted the first timetable for the reduction of emission. Other conferences included the 1989 Conference on Global Warming and Climate Change at New Delhi in India, and the 1989 Ministerial Conference on Atmospheric Pollution and Climatic Change at Noordwijk in the Netherlands and so on. For further discussion, see, for example, Bodansky, 1993 and 1994; Paterson, 1996, chapter 2.

³ Developing countries tended to see climate change in developmental as well as environmental terms, given its implications for industry, transportation and agriculture (Bodansky, 1993).

unconvinced and doubtful of a financial mechanism that is closely associated with the World Bank, an institution distrusted by the developing countries⁴.

Both the issues of the relationship between environment and development, and of financial mechanism, are highly relevant to the operations of the BWIs. In relation to the former issue, the BWIs and the developing countries, despite their differences, seem to have put “development” before “environment”. Developing countries are concerned that the prospect of their development, the traditional “economic” type of development, might be threatened if the burden of limiting GHGs emissions falls on their shoulder or diverts their resources for “economic” development. The BWIs, with their structural adjustment lending and programmes, have been promoting the same model of “development” without sufficiently taking into account the need to protect the environment⁵. From this perspective, both the BWIs and the developing countries appear to aim for the same thing — “economic” development⁶.

In relation to the issue regarding the financial mechanism of the Convention, however, developing countries were reluctant to accept a World Bank-associated GEF, notwithstanding the same view of development model they share with the BWIs. Developing countries rejected GEF from the onset of the negotiation because they regarded GEF P, to which the World Bank served as one of the Implementing Agencies, as too much donor-dominated. Developing countries would prefer a number of smaller funds to be set up outside the scope of “pre-existing, and generally donor-dominated,

⁴ As one commentator puts it: “Criticisms of GEF by developing countries had much to do with an underlying mistrust of the World Bank.” (Paterson, 1996, p. 77.)

⁵ For further discussion on structural adjustment and the environment, see Chapter 5.3.1.

⁶ Note that this convergence of view does not invalidate the previous propositions relating to the relationship between the BWIs and the developing countries. The goal of achieving economic growth has never been disputed between the BWIs and their borrowing developing countries. It is the ways in which programmes to achieve this goal are designed and imposed by the BWIs that raise controversies.

multilateral development institutions” (Jordan and Werksman, 1994a, p. 69)⁷. Developed countries and the World Bank have, on the other hand, favoured GEF to be designated as the financial mechanism of the FCCC.

This peculiar position of developing countries, ie sharing the same goal of “economic” development with the BWIs on the one hand but distrusting the Bank to run the financial mechanism of the FCCC, could be explained by several reasons. One reason might be that the linkage between climate change and “sustainable” development has not been fully appreciated by the developing countries from the start of the climate change debate⁸. With sufficient and proper financial and technological assistance, developing countries are offered a chance to achieve sustainable development and to deal with the potential impact of climate change⁹. Another reason might be that, the developing countries have had enough of the asymmetric treatment they receive in the BWIs¹⁰ that they do not want a BWIs-style mechanism in the FCCC in case it exacerbates the asymmetry problem associated with climate change as has been identified at the New Delhi Conference on Global Warming and Climate Change (the New Delhi Conference)¹¹. From this perspective, the developing countries’ deep-rooted discontent with the BWIs might have overshadowed the common goal of promoting “economic” development.

⁷ This, again, echoes the propositions presented in the preceding chapters arguing the discontent developing countries generally felt toward the BWIs. Had the developing countries satisfied with the operations of the BWIs, they would have trusted GEF, whose pilot phase was closely associated with the World Bank, to run the financial mechanism of the Convention.

⁸ For example, the developing countries wanted the “right to development”, development as in “economic” development, to be inserted into the Article on “principles” in the Convention.

⁹ For example, in the energy sector, if the developing countries are provided with technology on energy conservation or renewable energy, they can increase their energy consumption to satisfy their development demand without aggravating the problem of climate change at the same time.

¹⁰ See Chapter 2.2.1 for further discussion.

¹¹ For a discussion on the asymmetry problem associated with climate change, and on the interaction between asymmetry associated with the BWIs and asymmetry in the climate change regime, see Chapter 5.2.2.

In the end, compromises were reached with regard to both the issues of relationship between environment and development and of financial mechanism. The developing countries dropped their insistence to recognise expressly “right to development” in the Convention¹². A restructured GEF that is transparent, open to universal participation, and with a more equitable decision-making process was designated as the interim financial mechanism of the Convention. This compromise emerged from the climate change negotiation has implications on both the developing countries and the BWIs. For developing countries agreeing to the FCCC no longer means foregoing the opportunities to develop in a more sustainable manner. For the BWIs, in particular the World Bank, the developing countries’ acceptance of a restructured GEF has brought a closer link with the FCCC, which, as discussed in Chapter 4, could help to improve the relationship between the Bank and its developing country members¹³.

Before turning to examine the Convention and the three COPs, another point worthy of further discussion concerns the outcome of GEF negotiation. The FCCC Parties agreed to accept GEF as the interim operator of the Convention’s financial mechanism only after GEF agreed to restructure its governance structure; ie to become more transparent, open to universal participation, and have an equitable and balanced representation of all Parties (FCCC, Articles 11.2 and 21.3). The design of a financial mechanism in the Convention help to mitigate one aspect of the asymmetry problem

¹² A right to promote “sustainable development” is stipulated in Article 3 of the Convention.

¹³ Another potential implication of developing countries’ acceptance to a restructured GEF for the BWIs relates to their governance structure, in particular the voting arrangements. As has been mentioned in the preceding chapters, reforms of the decision-making process of the BWIs have been called for, in particular during the NIEO period (eg Ferguson, 1988, pp. 88-95). Various proposals have also been forwarded, (eg Gerster, 1994, pp. 95-97) but have all been failed so far. The fact that developing countries, as well as donor countries, have both been willing to accept the new decision-making arrangement of the restructured GEF, whose operation is closely associated with the World Bank, could shed some lights on the BWIs in terms of possible governance structure reform. Since the present study does not deal with the governance structure reform of the BWIs per se, this potential implication will not be discussed in more detail here.

associated with the climate change regime: the burden of controlling climate change¹⁴. The acceptance by the recipient countries of a restructured GEF with novel governance structure could have implication for the asymmetry problem associated with the BWIs as well. The function of the financial mechanism is to be guided by and accountable to the COP, at which every Party, developed or developing country has an equal vote in reaching decisions. The international entities entrusted to operate the financial mechanism are to be guided by the policies, programme priorities and eligibility criteria decided by the COP (FCCC, Article 11.1). The restructured GEF has a unique governance structure¹⁵ where developed countries can no longer dominate the decision-making process where policies and conditions regarding the GEF project are made. In this regard, this new feature breaks away from the set of decision-making rules under the BWIs where economic power has been the sole consideration in allocating votes. As a result, the FCCC and its interim financial mechanism, GEF might shed some light on the BWIs with regard to how to deal with the asymmetry problems inherent in their systems¹⁶.

5.1.2 The Convention and the decisions of the Conference of the parties (COP)

The objective of the Convention and any related legal instruments that the COP may adopt is to achieve stabilisation of GHGs concentrations in an atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system.

¹⁴ For detail discussion on the asymmetry problem associated with the climate change regime, see Chapter 5.2.2.

¹⁵ See Chapter 4.2 for further discussion on the decision-making procedures of the restructured GEF.

¹⁶ As will be discussed in the succeeding section, the thesis does not attempt to come to a conclusion as to which system is “fairer” than the other does. It merely tries to point out that, since developing countries are guaranteed the opportunities to participate more fully in the decision-making process of GEF, conditionality and similar tools associated with GEF and the FCCC might become less contentious and more successful in achieving the desirable result.

During the process of achieving stabilisation, the Convention should ensure that the timeframe is sufficient to enable economic development to proceed in a sustainable manner (FCCC, Article 2). In the course of implementation, the Parties to the Convention shall be guided by the principles set down in Article 3. As for treaty obligations, they are essentially laid down commensurate with the capacities of Parties. Parties to the Convention are divided into four groups: Annex I Parties, Annex II Parties, non-Annex I Parties, and the less developed country Parties¹⁷. Article 4 provides different sets of obligations to Parties in different categories¹⁸.

Article 4.7 conditions the effective implementation by developing country Parties of their commitments on the effective implementation by developed country Parties of their commitments related to financial resources and transfer of technology. Recalling the kind of conditionalities operated in the mechanisms, SAP as well as GEF¹⁹ of the BWIs, where developing countries are required to implement conditions before receiving or in utilising money from mainly the developed countries, the FCCC seems to set an “inverse conditionality”²⁰ on developed countries for a change. The BWIs, of course, are not bound by this provision. Nevertheless, this provision might influence the Executive Directors (EDs) from the developed countries sitting on the Board. The EDs are international civil servants, who, theoretically, cannot accept directions from their country of nationality. In practice, however, they are usually influenced by their domestic

¹⁷ The criteria for this categorisation are nowhere to be found in the Convention. The Convention lists countries which are Annex I and Annex II Parties and it is assumed that countries not on these two lists are non-Annex I Parties. However, the Convention does not explain why those countries are on these two lists in the first place, either.

¹⁸ What those obligations entail are provided in Article 4 and will not be described here. For further discussion, see, for example, Bodansky, 1993; Panjabi, 1993.

¹⁹ See Chapters 3.4 and 4.3.2 for more detailed discussions.

²⁰ See Chapter 4.3.2 for more detailed discussions.

policy consideration²¹. Therefore, when reaching any decisions that might affect the treaty obligations undertaken by developed country parties, EDs from the developed countries will need to bear in mind the requirement sets down in Article 4.7 of the FCCC. For example, if the Board of EDs has in front of it a SAP with climate change-related policies, EDs from developed countries might want to re-examine the amount of money and the type of technical assistance provided by this SAP. This is because such a SAP indirectly promotes the implementation by developing government of its obligations under the FCCC, and, under Article 4.7 of the FCCC, developed countries are required to provide financial and technological assistance before developing countries undertake to implement their treaty obligations. As a result, this FCCC provision, and other treaty obligations for the developed countries, might bear implications for the operations of the BWIs, which will be examined in more detail in the following section.

Due to the short timeframe of the INC negotiating process and the amount of contentious issues to be negotiated, the negotiations “were not truly completed” (Dasgupta, 1994, p. 131) and the COP is to carry out the negotiations of certain issues which have remained unresolved at the INC process. The “battles” between and within the developed and developing countries during the INC negotiation process were, consequently, extended to the COP that follows. In addition, the FCCC is only a framework convention. More detail and substantive obligations need to be fleshed out by the COP, the supreme body of the Convention²² (FCCC, Article 7). The COP, after its

²¹ The relationship of the Executive Directors with the member governments that appoint or elect them is not mentioned in the Articles of Agreements. The Executive Directors are, on the one hand, expected to express the views of the countries they represent; and, on the other hand, officials of the BWIs and receive their salaries from them. Larger countries, such as the five members who can each appoint one Executive Director, “tend to use the leeway inherent in this dual character of the Executive Directors’ role for the benefit of their own country” (Gerster, 1993b, p. 92).

²² For example, the COP is to provide guidance to the financial mechanism and to decide on its policies, programme priorities and eligibility criteria related to the Convention (FCCC, Article 11.1).

first session in March 1995, one year after the date of entry into force of the Convention, is to be held every year unless it otherwise decides (FCCC, Article 4.4). Four sessions of the COP have been held as of March 1999²³.

One of the innovative mechanisms of the World Bank stemmed from the decision of the COP 1, which established a pilot phase for joint implement among Annex I Parties and, on a voluntary basis, with non-Annex I Parties (Decision 5/CP.1, 1995). That decision of activities implemented jointly provides the basis of the Bank AIJ programme²⁴. Guidelines are provided in the decision on how AIJ will be carried out. The COP 3 adopts a uniform reporting format for Parties undertaking AIJ projects to submit their reports to the Secretariat (Decision 10/CP.3, 1997). The World Bank AIJ programme will assist its members participating in its AIJ projects to prepare and to submit such report to the Secretariat. The COP 4, after reviewing the second synthesis report on the AIJ projects, decided to continue the pilot phase and to begin preparations for a review process of the pilot phase (Decision 6/CP.4, 1998).

The process of negotiating a protocol began its initial work at the COP 1 (Decision 1/CP.1, 1995). At the COP 2, the Geneva Declaration adopted instructs the Parties to accelerate negotiations on the text of a legally binding protocol or another legal instrument to be completed in time for the adoption at the COP 3. At the COP 3, the first protocol to the FCCC, the Kyoto Protocol was adopted after an intense and highly publicised negotiation. The Kyoto Protocol will only enter into force after “55 Parties to the Convention, incorporating Parties included in Annex I which accounted in total for at least 55 per cent of the total carbon dioxide emissions for 1990 of the Parties included in

²³ Detail discussion and the significance of the COPs will not be described here. For more information, see Rowlands, 1995 for COP 1; Burns, 1996 for COP 2; and, Yamin, 1998 for the Kyoto Protocol concluded at COP 3.

Annex I” (Kyoto Protocol, Article 25), have ratified the Protocol. As of COP 4 in 1998, 60 Parties, including the US, to the FCCC have signed the Kyoto Protocol. It is difficult to predict when, or whether, the Protocol will enter into force since the US congress has indicated that it will not ratify any Protocol that has no substantive commitments for developing countries. However, the Kyoto Protocol itself marks an important milestone in the climate change regime. It has significant implications for the World Bank’s innovative mechanisms, as will be discussed in the succeeding section.

5.2 The FCCC and the BWIs

The 1992 UNFCCC is a remarkable piece of legal instrument that seeks to incorporate the spirit of sustainable development, which in essence require an integrated approach to economic, social and environmental development²⁵. The cause of climate change is relevant to the economic activities associated with the type of development that seeks to maximise economic growth, a model that has been advocated in the past by the BWIs. The solution to climate change will also affect every aspect of modern economic lives, which happens to fall within the competence of the BWIs — the regulators of international economic affairs. The relationship between climate change and “economic” development will be demonstrated firstly. Furthermore, as the overlap between membership and areas of competence increase, the interaction between the FCCC and the BWIs needs to be examined in more detail, which will be looked at in the second sub-section.

²⁴ For further discussion on the AIJ programme in the World Bank, see Chapter 4.1.2.2.

²⁵ Literature abounds regarding the implications of the FCCC on the concept of sustainable development. See, for example, Sands, 1994; and, Lang, 1995.

5.2.1 *Climate change and “economic” development*

The FCCC is intended to tackle the threat of global warming and climatic change resulting from the problems of the increasing greenhouse effect. The greenhouse effect is a naturally occurring phenomenon. The so-called greenhouse gases (GHGs) in the atmosphere absorb infrared radiation and reradiate it towards the earth, causing the earth's surface temperature to raise²⁶. The largest man-made GHG is carbon dioxide, (CO₂) resulting mostly from the burning of fossil fuel. During the past century, the “greenhouse effect” became the “greenhouse problem” as human activities enhanced the natural greenhouse effect through the release to the atmosphere of billions of tones of CO₂ and other GHGs (Mintzer and Leonard, 1994a).

Historically, anthropogenic sources of GHGs have been closely related to industrialisation, population growth and economic development. When the industrial revolution began at the turn of the century, the nature of the new technologies brought in is characterised by the massive consumption of fossil fuels, particularly of coal and oil (Uzawa, 1991). As the subsequent human economic activities expanded, the emission of several GHGs, in particular CO₂ has increased substantially, leading to high atmospheric concentrations of GHGs. The Second Assessment Report of the IPCC, endorsed by the Parties to the FCCC at the COP 2, has concluded that there is “a discernible human influence upon the climate system”.

The sources of GHGs are embedded in the global economic structure; that is, industrialisation and economic development. On the other hand, controlling emissions of GHGs, particularly CO₂ goes to the heart of the daily economic activities and has

²⁶ For a general scientific background of the greenhouse effect, see the Second Assessment Report of the IPCC: Houghton et al, 1995.

enormous implications for current industrial, agricultural, energy and transport policies and practices (Churchill, 1991).

As discussed in the preceding chapters, the traditional development model promoted by the BWIs and pursued firstly by developed countries and now by developing countries, has been equated with “economic” development and has largely been measured by the level of industrialisation. The developed countries have achieved this type of “development” by emitting a large amount of GHGs into the atmosphere during their development processes, which is evident from their estimated three-quarters of CO₂ emissions globally. In the developing countries, economic and industrial growth accounted for more than two-thirds of the increase in CO₂ emissions (Han and Chatterjee, 1997) Considering the low level of economic development and the consequent huge potential for growth, the future GHGs emissions are expected to come from the developing countries.

The primary objective of the policymakers in the developing world is to raise the standard of living of their people, and economic growth is imperative to alleviate poverty²⁷. It is, hence, unrealistic and unfair to argue for the reduction of energy consumption and of GHGs, especially CO₂, emissions in the developing countries²⁸. If this need for development of the developing countries is aided and financed by the BWIs through their traditional SAPs, developing countries will aggravate GHGs problems,

²⁷ The G-77, representing more than 120 developing countries during the INC-4, jointly put forward the “Principles of G-77 and China on the climate convention” proposing several formulations as the basis for negotiation. One of the formulations is “right to development,” which states that: “The right to development is an inalienable human right. All peoples have an equal right in matters relating to living standards. Economic development is the prerequisite for adopting measures to address climate change.” (Hyder, 1992, Table 1.)

²⁸ Note that some developed countries, in particular the US, have been arguing that developing countries, especially those with potential to become major emitter themselves, should undertake substantial commitment to reduce GHGs emissions. However, this need of the developing countries, need for growth, has been recognised in the FCCC. The Preamble affirms that responses to climate change should take into

since they will embark on a development path that, as identified in the preceding paragraph, is a major cause of climate change. This, however, can be mitigated in two circumstances. Firstly, a reformed SAP of the BWIs that incorporates environmental considerations might be able to guide the developing countries to adopt a sustainable development path that does not emphasise exclusively on industrialisation and economic growth. Evidence is growing that macroeconomic policy changes, a strength that can be introduced by a SAP, will strongly affect future GHGs emissions and that it is in a country's best interests to pursue actions that also capture climate change benefits (World Bank, 1997a). Secondly, the new mechanisms of the World Bank, with a more balanced governance structure for developing country members to participate, are designed primarily to assist the developing countries to implement the FCCC. In addition, the new mechanisms, with the innovative elements similar to, for example, emission trading, will be able to control the overall global GHGs emission. Both of these circumstances will be elaborated further in the succeeding discussion.

To conclude briefly, the causes of as well as solutions to climate change involve the whole range of the human economic activities and are influenced by the development path a country decides to adopt. Consequently, the FCCC has an exceptionally broad scope, encompassing not simply environmental protection as traditionally conceived, but economic and development policies more generally (Bodansky, 1995). According to the Head of the Indian Delegation in the FCCC negotiation process, a climate convention "could constitute a major multilateral economic agreement" (Dasgupta, 1994, p. 131). With the macroeconomic-centered SAPs and the FCCC-inspired innovative mechanisms

full account "the legitimate priority needs of developing countries for the achievement of sustained economic growth and the eradication of poverty".

such as GEF, AIJ, and GCI, the BWIs, in particular the World Bank, are well-placed to assist their developing country members to achieve the objectives of the FCCC.

5.2.2 *Interaction between the FCCC and the BWIs*

As the preceding discussion points out, a substantial overlap in the areas of competence has emerged between the BWIs and the FCCC. This overlap has brought a closer relationship between the BWIs and the FCCC in the context of treaty obligations each prescribed for its member states. Before turning to the discussion on how treaty obligations under the FCCC might affect the regular operations of the BWIs, we need to take note of another aspect of the interaction between the two, and that is the asymmetry problem associated with both regimes. The “important asymmetry” associated with climate change, first articulated by the New Delhi Conference on Global Warming and Climate Change²⁹ and summarised by Slinn, (Slinn, 1991) has the following characteristics. The historical and current emissions of GHGs have come from the developed countries; while many of the most serious effects of global climate change will occur in the developing countries³⁰.

Another crucial element in this asymmetry, identified by Slinn, is the burden of controlling climate change (Slinn, 1991, p. 77). The preservation of rain forests and curbing of dangerous emissions have been identified as some of the mitigation measures to control climate change. A truly global effort is required to limit GHGs emissions.

²⁹ This Conference was held in February 1989 to address specific problems that the developing countries are likely to face. This was the first conference in which perspectives on global warming from developing countries were voiced. For a detail account on the proceedings of the Conference, see: Gupta and Pachauri, 1989.

³⁰ The FCCC specifically recognises the difficult situation of developing countries (for example Article 3.2). Developing countries, particularly those on the ragged edge of subsistence with few resources to divert to dealing with climate change, are probably more vulnerable to global warming than are developed countries (Nordhaus, 1991).

However, while all the countries, developed and developing alike, need to share the cost of controlling emissions, only developing countries where the rain forests are located are most affected by the former type of measures, ie preservation of forests. Without external assistance, those developing countries are required to shoulder the cost of both emission reduction and forests preservation to combat climate change, a problem to which they historically did not contribute. This asymmetry between developed and developing countries in association with climate change reminds us of the asymmetric treatment in the international economic regime, as discussed in Chapter 2. Under the international economic regime regulated by the BWIs, developing countries have perceived themselves as being treated asymmetrically³¹. The governance structure of the BWIs is perceived by developing countries as one major cause of this asymmetry. The weighted-voting system gives the developed countries a greater influence in the decision-making process; while the majority of these decisions have tremendous impact on the developing countries³².

The two sets of asymmetry bear interesting comparisons from developing countries' perspective. For example, the international economic regime, shaped and operated by the BWIs, was mainly the outcome of the negotiation among the developed countries, and is still more dominated by the developed countries through the governance structure of the BWIs. In the climate change regime, problems associated with climate

³¹ For example, one type of asymmetry concerns the degree of influence of the BWIs over the policy-making process in developing and developed countries. As one commentator points out that developing countries are "required to endure a degree of BWI involvement in policy formation that would not be tolerated for a moment by OECD governments, who routinely discount the 'surveillance' advice of the IMF" (Killick, 1995b, p. 33).

³² The discontent of the governance structure of the IMF has first been expressed by the G-24 at its very first meeting in April 1972. In the Communiqué of its first Ministerial Meeting, the Group "expressed its dissatisfaction that important decisions affecting the International Monetary System have been taken by a small number of developed countries to the exclusion and neglect of the interest of the rest of the international community, and that these decisions have adversely affected the economies of developing countries." (Sauvant, 1981, p. 298.)

change are the outcome of the development path historically undertaken by the developed countries that emphasises economic growth and industrialisation, and the financial and technological means needed to tackle the problems are mainly at the hands of the developed countries. The developing countries have to live with the impact of BWIs' operations and of climate change, to which they historically could not or did not contribute. In the case of the projects and programmes from the BWIs, the borrowing developing countries have no other alternatives but to comply with, and to live with the consequences and impact of, conditionalities that are largely defined by the BWIs where developed countries hold the majority of votes³³. In the case of the climate change regime, the developing countries will, as has been identified at the New Delhi Conference, experience some of the worst effects of global climate change, and bear incommensurate burden to control climate change problems.

The two sets of asymmetry can interact with each other as well. The BWIs might help to balance the asymmetry in the climate change regime by, for example, providing adequate resources to the developing countries to control climate change. The BWIs might, on the other hand, aggravate the asymmetry problem associated with climate change with its own asymmetry problem. For example, the BWIs' projects and programmes might be designed by the developed countries who may try to avoid their historical responsibilities by imposing conditionalities that burden the borrowing developing countries disproportionately in controlling climate change³⁴. In this case, developing countries might find themselves being trapped in a "double asymmetry" since

³³ Developing countries as a group do not have the voting power to take decisions relating to the design of conditionality, while developed countries as a whole can prevent approval of any of these decisions. Developed countries thus "have the dominant say in defining conditionality and approving requests for use of Fund resources" (Ferguson, 1988, p. 203).

they have little influence over how the BWIs' projects and programmes are decided *and* they are required to shoulder the burden of controlling a problem for which they have little historical responsibility.

The asymmetry problem associated with climate change has, after intense negotiations between and among developed and developing countries, been mitigated by the international treaty that addresses the problem of climate change: the UNFCCC. The FCCC and the Kyoto Protocol, from the developing countries' viewpoint, represent a multilateral framework³⁵ that seek to deal with the asymmetry problem associated with the climate change regime. Developed countries, categorised as Annex I Parties in the FCCC, undertake more substantive treaty obligations as an implicit recognition of their historical responsibilities (FCCC, Article 4.2; Kyoto Protocol, Article 3). In addition, they are required to provide financial and technological resources to assist developing countries to deal with the impact of climate change (FCCC, Article 4.3 and 4.7). A financial mechanism, which shall have an equitable and balanced representation of all Parties within a transparent system of governance, is defined in the FCCC (Article 11). Whether these provisions have actually mended the asymmetry problem identified by developing countries will depend on the effectiveness of implementation of these provisions, which remains to be the subjects under review by the COP. However, these provisions have at least provided a mechanism, an opportunity to deal with the asymmetry problems associated with the climate change regime. The BWIs, on the other hand, are actually one part of the asymmetry problem associated with the international

³⁴ For example, developed countries can, via the Board of Executive Directors, prescribe conditionality such as the reduction of GHGs emissions by certain percentage in the borrowing developing countries in exchange for financial assistance.

³⁵ For example, in order to assure the participation of developing countries, a trust fund to defray the costs incurred to certain developing countries in their attendance at the negotiating sessions was established by

economic regime from the developing countries' perspective. For example, while the impact of the decisions of the BWIs relating to lending operations fall mostly on developing countries, these decisions are reached in an environment where developing countries considered themselves underrepresented in terms of numbers of votes allocated to them³⁶.

For the developed countries, however, things might look a bit different. Developed countries might not regard the BWIs and conditionalities imposed on the borrowers as representing any asymmetry since they contribute most of the resources to the institutions and are entitled to determine how their money will be spent³⁷. Meanwhile, they might perceive the FCCC and the Protocol as imposing asymmetrical treatment on them since they are asked to take on more obligations than the developing countries³⁸. As a result, neither of the two, the BWIs and the FCCC, can satisfy both developed and developing countries as an "ideal" system in which a "symmetrical world" can be achieved.

One must reckon that, despite the many similarities they share, the two systems represent different regimes³⁹ designed to deal with different sets of problems. First of all,

the same UN General Assembly Resolution (45/212) that set up the INC in December 1990. For further discussion, see Hyder, 1994, pp. 203-204).

³⁶ Various proposals have been put forward to reform the methods through which votes are allocated. It has been argued that votes should be allocated based not only on economic power but also on population, capacity for development and supply of raw materials. See, for example, the Communiqué, G-24, seventh Ministerial Meeting, 9-10 June 1974, reprinted in Sauvant, 1981, pp. 307-308.

³⁷ This can be demonstrated by, for example, why the developed countries played down the role of the UN ECOSOC and patronised the BWIs with the beginning of the cold war. One of the reasons for this Western preference for the BWIs over the UN ECOSOC was the decision-making procedure of the BWIs (Dasgupta, 1998, pp. 72-73).

³⁸ This can be illustrated, for example, by the US's position on the negotiation of the Kyoto Protocol. The US Senate has already indicated that it will not ratify the Kyoto Protocol or any convention under which developing countries do not bear substantive commitments with regards to GHGs emission reduction.

³⁹ The word "regime" has its specific meaning under international relations school, see, for example, Levy et al, 1995. However, the term, international economic "regime" and climate change "regime", is used more loosely here in referring to an environment under which rules, institutions, human behaviour and other factors interact with one another. On the other hand, the BWIs and the FCCC "systems", as shall be

the governance structure of the BWIs is one of the causes of the asymmetry perceived by developing countries under international economic regime, and the BWIs have not dealt with this asymmetry to the extent that satisfies their developing country members⁴⁰. On the other hand, the FCCC and the Kyoto Protocol are evolved partly to deal with the asymmetry problem associated with the climate change regime. Secondly, despite the ultimate goal of these two systems is the pursuit of sustainable development, their objectives and short-term aims are different from each other. The BWIs seek to address economic difficulties in their member states and to create a well-functioning international economic environment; while the FCCC seek to stabilise GHGs concentrations in the atmosphere. Thirdly, the *modus operandi* is also different between these two systems. The FCCC is an international treaty that sets down rules by which Parties are required to abide. The BWIs are established by their respective Articles of Agreements, which are international treaties as well. Nevertheless, the BWIs have developed sophisticated institutions, such as Executive Boards and a large body of professional staffs, whose operations are similar to co-operatives in that members contribute to a pool of funds from which they can borrow in the hour of need. It is, thus, understandable that the governance structures of the two systems are different. In sum, it is difficult to determine which system is better than the other and the fundamental differences between the two needs to be recognised. Nevertheless, the interactions between the two systems are likely to increase, as has been discussed previously, because of their substantial overlap in operation and in membership. We will now turn to the discussion on the interaction between the BWIs and the FCCC.

discussed later on, refer to sets of formal rules and institutions operating under international treaties — Articles of Agreements of the BWIs and the Convention itself.

Table 5-1 presents the comparison between the BWIs and the FCCC, including their differences and similarities.

TABLE 5-1: Comparison between the BWIs and the FCCC

COMPARISON		BWIS, ARTICLES OF AGREEMENTS	FCCC, KYOTO PROTOCOL
Differences	Governance	Weighted voting based on financial contribution	One country, one vote.
	Obligations ⁴¹	More obligations for developing countries because of more frequent use of resources.	More substantive obligations for developed countries, in particular under the Kyoto Protocol.
	Leverage	Developed countries, as they hold the majority votes in the decision-making process of the BWIs.	Developing countries, as their cooperation is crucial to the success of the FCCC ⁴² .
Similarities	Historical force leading to establishment	Both were mainly the result of inadequate policies pursued by developed countries ⁴³ .	
	Negative impact: should the system fail?	Both have or will have negative impact on every country in the world ⁴⁴ .	
	Source of finance	Both are financed largely by developed countries ⁴⁵ .	
	Legal character	Both the Articles of Agreements of the BWIs and the FCCC are binding international legal treaties.	
	Membership	Large overlap in membership ⁴⁶	

⁴⁰ For example, although calls for reforming the voting rules came as early as in 1972, the proportion of basic votes, which are allocated equally among all members, in the IMF have been decreasing with each review of quotas conducted every five years (Gerster, 1993a).

⁴¹ This refers to both treaty obligations and obligations arising from loans in the case of the BWIs.

⁴² For further discussion on how developing countries have gained greater leverage under international environmental negotiation, see: Hurrell and Kingsbury, 1992.

⁴³ The protectionist policies practiced by most of the developed countries in the 1940s contributed to the chaotic world order that led to the outbreak of WW II. The ruthless pursuit of industrialisation and unlimited economic growth by the developed countries since the age of industrialisation are one of the main causes of climate change.

⁴⁴ A failed BWIs will have implications on the international economic order, which will affect not only developing but developed countries as well. In case where the FCCC fails to get fully implemented, the resulting increase of the GHGs concentration and climate change will have devastating effect on every single country on earth.

⁴⁵ In the case of the FCCC, providing financial assistance is actually a treaty obligation for the developed country parties (FCCC, Article 4.2).

From Table 5-1, we can find striking similarities between the BWIs and the FCCC. However, they have fundamental differences as well. What are, then, the interaction between the obligations under the FCCC and the Kyoto Protocol and those of the BWIs? And how does the existence of the FCCC affect the operations of the BWIs?

As previously pointed out, the causes of and solutions to climate change require re-examination of every aspect of our economic activities, which implicate the overlap of competence between the BWIs and the FCCC. Nevertheless, under the treaty regime of the FCCC and Kyoto Protocol, substantive treaty obligations have not yet comprehensive enough to cover such a wide range of economic aspects that come into the competence of the BWIs⁴⁷. Why, then, does the existence of the FCCC and Kyoto Protocol affect the regular operations of the BWIs? The answer lies in the impact the operations of the BWIs could have on the climate change regime.

First of all, while the World Bank has the largest renewable energy portfolio of any institution in the world, renewable energy only represents about 10% of the total energy portfolio value in the last six years (World Bank, February 1998a). The Bank still has large lending operations to fund fossil fuel-related projects in the developing countries⁴⁸, resulting in large amount of GHGs emissions. Secondly, the existing design and operations of the SAPs of the BWIs have, as will be demonstrated in the succeeding section, implications for the climate change regime as well. The design of the existing

⁴⁶ All the Parties to the FCCC are member states of the BWIs. There are 176 parties to the FCCC as of October 1998, 183 member states of the IMF and 181 member states of the IBRD.

⁴⁷ Although Article 4.1(f) requires all Parties to take climate change considerations into account in their relevant social, economic and environmental policies and actions, it does not impose concrete obligations such as limiting the type of economic or developmental policies Parties are allowed to adopt. This is more vividly illustrated in the case of developing countries that are not subject to the only set of substantive obligations of reducing GHGs emissions under the FCCC and Kyoto Protocol. For example, developing countries can, in principle, pursue an unlimited economic growth and a higher level of industrialisation to the extent that their potential GHGs emissions level will reach that of the developed countries.

⁴⁸ In FY 1997, World Bank (IBRD and IDA) lending for oil, gas and coal represents nearly 19% of the total commitments in the energy section, the figure rises to 43% in FY 1998.

SAPs has the development model, ie economic growth and industrialisation pursued by the developed countries in mind. The correlation between this development model, ie “economic” development and global climate change has already been demonstrated in the preceding section. Therefore, it is this potentially negative impact the operations of the BWIs could have on the climate change regime that we examine to what extent does the existence of the FCCC affect the operations of the BWIs.

The interaction between the FCCC and the BWIs will be analysed from three perspectives: the BWIs themselves, the developed countries which hold the majority votes in the Boards of Executive Directors, and the developing countries. In order to determine how does the existence of the FCCC affect the regular operations of the FCCC, we need to examine what are the legal obligations, if any, under the FCCC for each of these three groups, and what kind of conflict might arise as a result between these obligations of the FCCC and the existing operations of the BWIs.

From the perspectives of the World Bank as an international organisation, it needs to be pointed out from the beginning that the Bank itself is not a Party to the FCCC and is ineligible to become one under the FCCC⁴⁹. In addition, the Articles of Agreement of the Bank and the provisions of the FCCC can hardly be categorised as “regulating the same subject matter”. As a result, principles under the law of treaties are inapplicable in this context. In principle, thus, the World Bank as an international organisation does not carry any legal obligations toward the FCCC, and should not be affected by the existence of the FCCC. However, the following developments seem to suggest otherwise. First of all, the Bank adopted an internal policy (OMS 2.36 on Environmental Aspects of Bank Work, May 1984) as early as in 1984 stating that the Bank “will not finance projects that

contravene any international environmental agreement to which the member country concerned is a party”⁵⁰. This internal procedural requirement prevents the Bank from funding projects that might contravene with the obligations of the FCCC. In addition, any affected citizen in the country where a Bank project is situated could bring complaint to the Inspection Panel in cases where the Bank violates this internal policy^{51, 52}. Furthermore, such a formal commitment of not financing projects that contravene any international environmental agreement “rises to the level of a limited legal obligation not to disregard the objectives and purposes of the MEA concerned” (Handl, 1998, p. 658). Secondly, the Bank, in writing the covenants in any loan agreement for investment projects, should avoid “covenants that would be inconsistent with, or that could not be performed without modification of, the domestic law of the member concerned” (OP 7.01 on Contractual Agreements, July 1994). In cases where the member concerned is a Party to the FCCC and has incorporated its treaty obligations into its domestic law, the Bank will have to respect the relevant provisions under the FCCC that have been transformed into domestic law.

Thirdly, the acceptance of the role as the Trustee of the GEF Trust Fund and as an Implementing Agency of the restructured GEF has implications for the Bank in its relations with the FCCC. The Bank, in its capacity as the Trustee of the GEF Trust Fund

⁴⁹ Article 22 of the FCCC states that only “States and regional economic integration organizations” are eligible to become Parties to the FCCC.

⁵⁰ However, after this OMS was published, the Bank still involved in several controversial loans which caused, for example, deforestation in the borrowing country (eg the Brazilian Polonoroeste project) that could have contravened the Convention on Biodiversity.

⁵¹ Following the 1987 reorganisation, OMSs were gradually reflected in new documents called “Operational Directives”, and not all OMSs have been converted to Operational Directives. Therefore, the Panel still needs to decide whether certain details in a specific OMS are provided as technical advice to the staff or are meant to be strictly complied with (Shihata, 1994b). It is not yet clear whether this provision in OMS 2.36 is subject to the competence of the Panel.

⁵² This scenario can arise in cases where the Bank finance a fossil fuel-related project in an Eastern European country, which has obligations under the Kyoto Protocol to reduce GHGs emission, that will

and the Implementing Agency of GEF, is accountable to the GEF Council, which, in turn, has to follow guidance from the COP to the FCCC with regard to climate change-related projects⁵³. By approving the restructured the GEF Instrument, the Bank, Sand has argued, is restricted in providing funding for “projects that would run counter to the objectives of the two new conventions which it is formally committed to implement” (Sand, 1996, pp. 495-96). Fourthly, the Bank is itself a subject of international law and “cannot stay aloof from, or be unaffected by, changing international public policy and normative developments” (Handl, 1998, p. 647). The FCCC admittedly does not contain provisions that refer specifically to international financial institutions such as the World Bank or the IMF. Nevertheless, Handl has argued: “... as members of the international community, multilateral development banks are subject not only to evolving international public policy and general international law, but also to the normative reach of those MEAs that have been adopted precisely to lay down principles and standards of global applicability” (Handl, G, 1998, p. 661)⁵⁴. As the FCCC no doubt qualifies as one of those widely adhered to MEAs that lay down principles and standards of global applicability, the Bank arguably should respect obligations prescribed under the FCCC when conducting its regular operations.

To sum up, the obligations of the FCCC do not legally bind the World Bank in conducting its existing operations. However, from the recent practice of the Bank such as its internal policies and approval of the restructured GEF, as well as development under

increase the GHGs emission of the country. This project clearly contravenes an international environmental agreement: the FCCC and Kyoto Protocol in this case.

⁵³ For further discussion on the implications for the World Bank acting as the Trustee of GEF Trust Fund, see Chapter 4.2.3.

⁵⁴ Handl concludes that there is even no need to amend the articles of agreements of multilateral development banks: “MDBs in general not only are free to take sustainable development concerns into account, but also have an international legal obligations to do so — not *despite* their constituent instruments but, rather ... *because of them!*” (Handl, 1998, p. 665.) (original emphasis.)

international law identified by legal scholars such as Sand and Handl, the existence of the FCCC bears profound implications for the World Bank in the sense that the Bank should, arguably, take into account obligations prescribed by the FCCC and the Kyoto Protocol when carrying out its existing operations⁵⁵.

The aforementioned analysis does not apply as readily to the IMF in its entirety. There are no decisions in the Fund similar to the Bank's OMS 2.36. Nor does the Fund assume any role under MEAs regime as the Bank does under GEF and the FCCC. Nevertheless, according to Sir Joseph Gold, part of the considerations when the Executive Board decided stand-by arrangement were not international agreements or treaties (Guidelines on Conditionality, para. 3) has been "the desirability of avoiding conflicts with other international organizations" (Gold, 1980a). It is conceivable, thus, that the Fund does not want to engage in activities that might result in conflicts with other international organisations, MEAs arguably included. Furthermore, the IMF is also itself a subject under international law. Thus, the argument by Handl in relation to the quasi-binding effect of the evolving international public policy and general international law should also apply *mutatis mutandis* in the case of the Fund. As a result, in so far as the Fund's role overlap to some extent with the Bank in the structural adjustment operations, which potentially have implications for climate change, the Fund arguably should also take into account development under the FCCC in conducting its structural adjustment-related operations.

⁵⁵ Similar discussion took place in the field of human rights protection as well. It has also been urged that "international organizations should not promote policies or provide funding in a manner that would undermine the member states' ability to fulfill their own freely assumed international legal commitments" because international organisations are "both subjects of international law and bound by its norms." (Bradlow and Grossman, 1995, p. 428.)

For developed countries they, as Annex I and/or II⁵⁶ Parties to the FCCC, bear more substantive obligations under the FCCC and Kyoto Protocol. They have a dual role under the BWIs: on the one hand, they have treaty obligations under the respective Articles of Agreements, such as to co-operate in the Fund's surveillance operation or to pay in subscription to shares; on the other hand, as the holder of majority votes as a group in the Boards of Executive Directors, they assert much influence over the decisions and operations of the BWIs⁵⁷. Under the circumstances, what kind of conflict can arise for the developed countries undertaking obligations under the BWIs and the FCCC and Kyoto Protocol? Their treaty obligations under the Articles of Agreements of the BWIs, such as subscription to shares and quotas, do not seem to interact much with the existence of the FCCC. In addition, since developed countries, in particular OECD members, no longer receive financial assistance from the BWIs, they are not subject to the programmes and policies prescribed by the BWIs. For example, they are not required to implement SAPs, whose policy content might have implications for the implementation of the FCCC. Therefore, it seems conceivable that developed countries do not have two sets of treaty obligations that might conflict with each other⁵⁸. However, their other role under the BWIs, ie their dominating position in the decision-making process of the BWIs, deserves more attention.

⁵⁶ Annex II Parties are all OECD members; while Annex I Parties are Annex II Parties plus economies in transition (Annex I and Annex II to the FCCC).

⁵⁷ For example, after examining the structure, purpose and voting system of the IMF and the IBRD, White concludes that "... it can be seen that it is dominated by the Western industrial powers" (White, 1996, p. 77).

⁵⁸ This conclusion mainly applies to developed countries that are OECD members. For economies in transitions (EIT) there is possibility where conflict could arise when they, for example, apply for funding from the World Bank for coal power plant whose GHGs emission level could result in a breach of treaty obligation under the Kyoto Protocol, under which EIT have substantive obligations to reduce GHGs emissions. The special case of EIT under this circumstance deserves more analysis. Nevertheless, since the main focus of discussion here is on developing countries, the case of EIT will not be elaborated in the present study.

One aspect from developed countries' perspective of the interaction between their treaty obligations under the FCCC and decision-making role under the BWIs relates to the amount of resource needed in approving a loan whose operations will have implication to the FCCC⁵⁹. In addition, there are other potential interactions, even conflicts, between the objective of the FCCC and impact of the BWIs operation from developed countries' perspective. For example, the Boards of Executive Directors might need to decide whether to approval a loan, such as a fossil fuel-related investment project or a structural adjustment lending whose policy suggestions might fail to take climate change implications into account, that could have potential negative impact on climate change, such as a global increase of GHGs emissions. Under this circumstance, if the Boards, where the developed countries hold the majority votes⁶⁰, approve such a loan, the objective of the FCCC will be undermined. As taking climate change consideration into account does not breach the criteria set down in the Articles of Agreements of the BWIs with regard to making loan decisions⁶¹, developed countries in their capacity as Executive Directors seem able to satisfy their obligations under both the FCCC and the BWIs by rejecting loans that could result in negative impact on climate change. This is how the existence of the FCCC can affect the regular operations of the BWIs from the developed countries' perspective.

For developing countries, they have not yet had substantive obligations relating to emissions reduction under the FCCC and the Kyoto Protocol at the time being. However,

⁵⁹ This is relating to Article 4.7 of the FCCC, for further discussion, see Chapter 5.1.2.

⁶⁰ Although the Boards usually reach its decision through consensus and rarely take a vote, the "voting strength of members remains a crucial consideration with regard to the evaluation of consensus on any matter" (Ferguson, 1988, p. 65). Thus, developed countries can still dominate the outcome of the meeting of the Boards.

⁶¹ For further discussion on the compatibility between the "economic consideration" prescribed under the respective Articles of Agreement of the BWIs and "sustainable development", see Chapter 1, and Handl, 1998.

according to the principle of *pacta sunt servanda* (Article 26, Vienna Convention on the Law of Treaties), a Party to the FCCC should perform treaty obligations of the FCCC in good faith, including not to engage in activities that run counter to the objectives of the FCCC. When a developing country is required to implement a SAP whose conditionality and policy suggestions might render this country incapable of complying with the FCCC in the future, potential conflict arises for this developing country between loan obligations from the BWIs and treaty obligations under the FCCC⁶². In this circumstance, it is up to individual developing country to decide how to respond to two different and sometimes incompatible sets of international obligations. Legally speaking, developing countries will not be in breach of FCCC obligations if they undertake projects or programmes that result in substantive GHGs emissions for they do not have such substantive obligations under the Kyoto Protocol. On the other hand, the need for energy consumption in developing countries is bound to increase if their standard of living is to reach a basic level⁶³.

Does this imply that developing countries can undertake any project and programme of the BWIs, even though such project and programme could undermine their future ability to implement the FCCC? In other words, does this mean that the existence of the FCCC has no impact whatsoever on the operations of the FCCC from the developing countries' perspective?

Not necessarily. The FCCC provides financial and technological assistance to its developing country Parties under certain conditions through GEF, its interim financial

⁶² This is a widely perceived problem when international treaties proliferated after the 1970s. For example, there has been a constant debate regarding the compatibility between MEAs with trade provisions and the GATT and WTO. A country faces contradictory treaty obligations from two different international regimes and finds it difficult to conciliate.

⁶³ This is one of the considerations why developing countries do not need to make substantive commitment at the time being. See the previous section for further discussion.

mechanism. In order to receive the financial and technological assistance, developing countries will need to refrain from undertaking BWIs obligations and instructions that might render itself unable to implement the FCCC in the future, and, consequently, become disqualified in receiving financial and technological assistance from the Convention. Does this mean that developing countries will chose to observe the overall objective of the FCCC in order to receive assistance from the FCCC, and forgo loans from the BWIs? This might depend on the amount of money a developing country will be able to receive from each of the two regimes. If the amount of money a developing country can receive under the BWIs loan exceed that under the FCCC, it can afford to forgo the assistance from the FCCC and opt for the BWIs loan instead. At the moment, it seems that, compared to GEF, the BWIs can provide a much larger financial assistance to their developing country members⁶⁴. However, more money usually means more conditionality, as has been discussed previously. Although it has been identified in Chapter 4 that GEF might begin to develop its own conditionality requirement, the BWIs-style conditionality seems to attract more criticism because of the governance structure of the BWIs that results in asymmetric treatment from developing countries' perspectives. Under the governance structure of GEF, however, developing countries will be able to participate in designing the conditionality developed under GEF. From the viewpoint of conditionality requirement, thus, it is not necessarily more advantageous for developing countries to opt for the BWIs since, under the FCCC regime, developing countries have more opportunity to take part in reaching decisions regarding how GEF money can be used in their own territories.

⁶⁴ To make a rough comparison: Russia received a Coal Sector Adjustment Loan in FY 1998 of US\$ 800m; while China received a Energy Conservation grant form GEF in FY 1997 of only US\$ 22m.

Therefore, from the perspectives of the developing countries, the existence of the FCCC does have implications for the regular operations of the BWIs. In order to qualify under the FCCC to receive financial and technical assistance from GEF, developing countries can either refrain from applying for project and/or programme loans that may have negative impact on climate change from the BWIs, or they can seek to change the decisions and policies of the BWIs through their own Executive Directors, both of which can affect the operations of the BWIs.

To sum up, as the preceding discussion demonstrated, the existence of the FCCC can affect the operations of the BWIs from the perspectives of all major groups involved: the institutions themselves, the developed countries and the developing countries. It is not to suggest that the BWIs should then subject themselves to the authority of the FCCC. Nevertheless, from the perspectives of all three, the BWIs seem no longer able to operate in total disregard of treaty obligations undertaken by their member states under the FCCC and the Kyoto Protocol. Before examining how then the existing mechanism of the BWIs, the SAPs, can be reformed in the light of the FCCC, and how the innovative mechanisms of the World Bank can be further developed, the next sub-section will look more specifically at the implications of the Kyoto Protocol on the World Bank.

5.2.3 Implications of the Kyoto Protocol to the World Bank⁶⁵

The Kyoto Protocol does not impose substantive commitments on developing countries. Under Article 10 of the Protocol, commitments in Article 4.1 of the Convention for all Parties are reaffirmed. It is specifically stated in Article 10 that new commitments for non-Annex I Parties, ie developing countries will not be introduced.

However, after the Annex I Parties have committed themselves to these substantive commitments in the Kyoto Protocol, the next logical step is to start negotiating modest commitments for developing country Parties if efforts made by Annex I Parties are not to be offset by the potentially enormous amount of emissions from the developing world. This negotiation might be even more difficult than that of the Convention and the Kyoto Protocol, which can already be detected from the thorny debate on voluntary commitments by non-Annex I Parties at the COP 4 in Buenos Aires in 1998.⁶⁵ Nevertheless, it will be necessary if the ultimate objective of the Convention is to be achieved: the stabilisation of GHGs concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system.

As a result, developing countries will need to start preparing themselves for the time when substantive obligations from future protocol arrive. This possible development under the FCCC on the part of developing countries will have further implications for the regular operations of the BWIs. As has been illustrated in the preceding discussion, the existence of the FCCC has already affected the regular operations of the BWIs to the extent that the BWIs can no longer carrying out their operations in isolation from any development under the climate change regime. If, in the future, developing countries have more substantive obligations under the climate change regime, they will need to refrain from undertaking projects or programmes that might increase their GHGs emissions and, as a result, lead to a breach of their treaty obligations under the climate change regime. Under this scenario, the BWIs will put their developing country members

⁶⁵ A detail analysis of the provisions of the Kyoto Protocol will not be conducted here, for further discussion, see: Yamin, 1998.

⁶⁶ At the COP 4, some developed countries, US for example, sought to secure voluntary commitments from developing countries with regard to targets and timetable for GHGs emissions reduction. Two developing countries, Argentina and Kazakhstan, announced that they would undertake voluntary

in a very difficult position if they continue to propose projects or programmes to these members that might hamper their developing country members' abilities to implement the FCCC or any future protocol.

In addition to the future development under the climate change regime with regard to substantive commitment and its implications on the operations of the BWIs, certain provisions in the Kyoto Protocol have already had implications for the World Bank's innovative mechanisms. The first one is the official sanction of joint implementation (JI) between the Annex I Parties. Although JI is only limited among Annex I Parties, namely the developed countries, at present, it opens the possibility that JI might be permitted between developed and developing countries⁶⁷. The Bank has indicated that its AIJ project selection criteria and evaluation guidelines are consistent with the objective of the FCCC. Nevertheless, the relationship between the JI under the Kyoto Protocol and the Bank AIJ programme remains unclear. For example, since JI under the Kyoto Protocol is limited among developed countries, it remains unclear whether the Bank AIJ programme will follow the JI operational guidelines developed by the COP serving as the Meeting of the Parties (MOP) to the Kyoto Protocol in the future. It is, thus, too early to see whether the Kyoto Protocol has any immediate or significant implications on the Bank AIJ programme. Nevertheless, as long as the possibility remains that JI could be undertaken between developed and developing countries, the Bank AIJ programme might attract more attention from donor as well as host countries. For example, there might be more agreements, similar to the one between Norway and

commitments. This, however, was heavily criticised by G-77 and China. For more discussion, visit the website on: <http://www.iisd.ca/climate/ba/>.

⁶⁷ After the Kyoto Protocol, the official JI refers to the bilateral relationship between two Annex I Parties. The CDM seeks to "multilateralise" the essentially bilateral-natured JI by providing a mechanism to supervise emission-reduction projects. In fact, the CDM has provided another form of JI between

the Bank, between other donors and the Bank in which the Bank plays a facilitative role in arranging AIJ projects. The Bank AIJ programme, thus, could have the potential to have wider scope of operations than its present arrangement. This is one of the implications the Kyoto Protocol might have for the World Bank.

From developing countries' perspective, this potential implication for the Bank AIJ programme might be beneficial. The developing countries might prefer having a mechanism like the Bank AIJ programme, preferably one that has closer link with the Kyoto Protocol⁶⁸, than leaving all the bilateral JI negotiation to themselves. From developing countries' perspectives, the unequal bargaining positions in bilateral JI negotiations might allow developed countries to impose new conditionalities or to promote projects that are not in the national interest (Werksman, 1998). Therefore, if all the JI projects can be arranged and overseen by the Bank AIJ programme having a close link with the Kyoto Protocol, developing countries might be able to gain more control over the operations of all the JI projects through the Kyoto Protocol and the FCCC.

Another provision of the Kyoto Protocol that potentially has significant implication for the World Bank is Article 12. The CDM defined in Article 12 of the Protocol has striking similarities with another innovative mechanism the Bank is in the process of setting up, that is the GCI/PCF⁶⁹. The COP serving as the MOP to the Protocol will elaborate modalities and procedures of the CDM at its first session. Operational entities will need to be designated by the COP serving as the MOP to the Protocol as

developed and developing country Parties. For further discussion on the concept of JI and its various forms under the Kyoto Protocol, see: Missfeldt, 1998.

⁶⁸ For example, formal agreement could be arranged between the Bank AIJ programme and the MOP to the Kyoto Protocol which gives the MOP the mandate to design project criteria and to oversee the operations of the AIJ programme.

⁶⁹ For information on the development and operations GCI/PCF, see Chapter 4.1.2.2.

well⁷⁰. As for the World Bank's GCI/PCF, it is not operational yet and further operational guidelines and procedures are still developing within the Bank. Considering the relatively small amount of money the PCF is able to obtain pledges so far (US\$ 100m) the Bank does not seem to envisage the PCF having any formal link with the CDM under the Kyoto Protocol. Furthermore, the PCF will be different from other financial mechanism, like GEF, in that private sector will play a large part in it. What are the implications of the CDM for the World Bank?

Although the Bank does not envisage any formal link between its PCF and the CDM under the Kyoto Protocol, the following considerations could push the Bank into another direction. Firstly, the Bank has extensive experiences in project identification and implementation, and has conducted advanced research in methodological issues through taking part in GEF and the AIJ programme. This "comparative advantage" puts the Bank in a position where the investors, in particular developed countries obligated with substantive commitment under the Kyoto Protocol, would prefer the Bank and its PCF playing a large part in the CDM. Secondly, if a formal relationship is established between the PCF and the FCCC and the Kyoto Protocol, the "carbon offset" obtained in the project funded by the PCF can then be credited under the Protocol. This is certainly desirable from the investors' perspective. Lastly, the potential financial benefit of the developing countries, as hosts in the projects arranged under the CDM, is at stake. The developing countries might prefer a formal relationship to be established between the PCF and the FCCC because they perceive the FCCC as a better forum over which they have more control. Taken all these factors into consideration, it is likely that some kind of agreement could be reached between the PCF of the Bank and the CDM under the

⁷⁰ For further discussion on the negotiation history and detail analysis of Article 12 of the Kyoto Protocol,

Kyoto Protocol. In that case, the development of the CDM under the climate change regime will have implications for the World Bank in its GCI/PCF.

In short, the Kyoto Protocol potentially has significant implications for the World Bank's JI-related innovative mechanisms. The official sanction of JI under the Kyoto Protocol could widen the scope of the present Bank AIJ programme. The establishment of CDM by the Kyoto Protocol might have implications for future development of the Bank's GCI/PCF. The earlier discussion demonstrates how the existence of the FCCC affect the existing operations of the BWIs and concludes that the BWIs will need to take into account obligations under the FCCC when carrying out their regulation operations. This section points out the potential implications of the Kyoto Protocol for the innovative mechanisms of the World Bank and suggests formal arrangements to be established between the Bank's innovative mechanisms and the Kyoto Protocol for the benefits of both developed and developing countries. The next section will look more specifically at how the existence of the FCCC can affect the existing operations of the BWIs by examining the relationship between the SAPs and the FCCC. Suggestions will be put forward as to how the design of the existing SAPs can be reformed in order to assist the developing countries to implement the FCCC.

5.3 SAPs with a "climate safety net"?

The SAP, its policy content and conditionalities attached are based on the economic model perceived by the BWIs as ideal for a country's economic growth — "development" in the traditional sense. Considering the lack of concerns over environmental factors in this previous development model, it is not surprising to find the

see Werksman, 1998.

lack of reference to the environment in the design of the SAPs. Before presenting suggestions to the reform of the SAPs in the light of the obligations under the FCCC, the next section will briefly examine the environmental impact of the current SAPs, with particular reference to the impact on climate change. It demonstrates that the SAPs have implications for the developing countries in implementing the FCCC.

5.3.1 SAPs and the environment, with particular reference to climate change

SAPs mainly contain suggestions of a set of macroeconomic policies in order to deal with the structural problems of a country. The process of structural adjustment usually involves evaluating and reformulating the macroeconomic economic policies of a country. The linkage between macroeconomic policies⁷¹ and the environment did not draw immense attention before the late 1980s and early 1990s. However, since the environmental impact of SAPs supported by the BWIs has become an issue subjected to controversial debate (eg Kothari and Kothari, 1993; Reed, 1992 and 1996; Rich, 1994), the interrelationship between macroeconomic policies and the environment has, as a consequence, begun to draw greater attention⁷². The discussion of the linkage between the two is an on-going debate. Starting with earlier debate on arguing whether or not macroeconomic policies have any impact at all on the environment⁷³, the focus has now moved towards ascertaining whether the impact is positive or negative, and attempting to

⁷¹ Macroeconomic policies are usually defined as: "fiscal and monetary policies that aim at achieving economic goals, such as control of economic stability, growth, full employment, and balance-of-payments equilibrium." (Shim and Siegel, 1995.)

⁷² For example, the IMF only began to consider the impact of macroeconomic policies on the environment and vice versa in early 1991. Its staff produced a limited number of working papers after 1990 to discuss general issues relevant to the environment (eg Levin, 1993; Muzondo et al, 1990; and, McMorran and Nellor, 1994). It also held two seminars, one in May 1993 and the other in May 1995, to discuss the relevant issues of macroeconomic policies and the environment with academics and NGOs and it published the proceedings of the latter in 1996 (Gandhi, 1996.)

⁷³ That is whether environmental policies will affect the macroeconomic situation of a country.

setting up a framework within which an integrated approach between macroeconomic and environmental policies can be undertaken (Gandhi, 1996).

The impact of various macroeconomic policies on the environment can both be direct and indirect, as well as negative and positive⁷⁴. Fiscal policy, which directs government spending and taxation for gearing the economy toward a growth rate that is neither too rapid nor too slow, is a good example to look at. Environmental tax has direct and, potentially, positive impact on the environment through the application of the “polluter pays principle”. Expenditure policy, in particular the requirement to cut down government expenditure, can have negative impact on the environment through a budget cut on the relevant environmental agencies; however, it can have positive impact on the environment through the elimination of subsidy which often results in the wasteful use of resources. Other adjustment measures, such as trade liberalisation or exchange rate policies, can alter the relative prices of different commodities, including energy sources such as petroleum, change the output structures or input combination, and, as a result, influence the pattern of resource utilisation (Jayarajah and Branson, 1995). In a word, no simple generalisations are possible as to the likely environmental effects of broad policy measures (Munasinghe, 1993).

In addition to the impact on the environment in general, some of the macroeconomic policy reforms involved in the structural adjustment process have either direct or indirect impact on the climate change regime. For example, price reform has been a major element in the process of structural adjustment. The change of the relative prices of input through, for instance, the elimination of subsidies will affect the types and quantities of resources used (Institute of Development Studies, 1991). This, as a

⁷⁴ For a number of good illustrations on this two-prong effect, see: Gandhi and McMorran, 1996.

consequence, can alter the pattern of fossil fuel used as energy input and affect the GHGs emission level of a country. The liberalisation of international trade, with the aim to increase government revenue, has been at the centre of most structural adjustment programmes (Zarsky, 1994). This advocacy of free trade policy can have an impact on the international trade of certain substances (or goods containing such substances), which might be subjected to restrictions under future protocols of the FCCC⁷⁵.

It is therefore fair to conclude that macroeconomic policies can have either positive or negative impact on the environment and on climate change, depending on the design and implementation of the relevant structural adjustment policy instruments. The design of programmes and policies of the SAPs in the past did not seem to consider their environmental impact⁷⁶. It has been argued, for example, that economy-wide policy reforms suggested by the IMF and the World Bank “have been encouraged with little regard to their environmental consequences due to the presumption that these effects could be ignored or could be dealt with separately” (Opschoor and Jongma, 1996)⁷⁷. Considering the models of “development”, ie unlimited economic growth, these SAPs seek to achieve fails to address the environmental constraints, it is understandable that SAPs themselves do not prescribe economic policies that take into account the environment.

⁷⁵ The FCCC is a framework convention without setting out any regulatory timetable of certain substances yet. The Kyoto Protocol, being agreed at the COP 3 to the FCCC in December 1997, sets down substantive obligations of emissions reduction for the Annex I Parties, and prescribes six types of GHGs that are subject to the reduction target. The Protocol, however, has not come into force yet and does not authorise the use of trade restriction.

⁷⁶ For example, the in-house historian of the IMF recognised the lack of environmental concern in the SAPs: “[The Fund] is also increasingly concerned with ... the impact adjustment programs and economic policies will have on the environment.” (De Vries, 1995, p. 45.)

⁷⁷ Even the research on the experience under the SAF and ESAF conducted by the IMF staff concluded that: “Environmental considerations began to come into play in ESAF-supported programs but demand greater attention.” (Schadler et al, 1993.)

Several case studies of the impact SAPs on the environment in countries undertaking a SAP have been conducted (eg Cruz and Repetto, 1992; Panayotou and Sussangkarn, 1991; Reed, 1992 and 1996). The results of these studies vary and general conclusions are difficult to draw. The environmental impact of SAPs concluded in these various case studies differs depending on several factors. For example, the yardsticks by which evaluation of the environmental impact is measured differ among bodies conducting the research; the methodologies applied in ascertaining the impact differ as well⁷⁸. In addition, no case study has been conducted so far to examine specifically the impact of the SAPs on climate change, such as the impact on the GHGs emission level of countries under the SAPs. However, it is conceded that environmental considerations, including those that have profound implications for climate change, have received insufficient attention in the design of a SAP and that an integrated approach should be adopted in the future design of a SAP⁷⁹.

5.3.2 Reform of the design of the SAPs

Call for environmental reform of the SAPs has been mounting from environmental and social groups since the 1980s. However, the response from the BWIs has been limited. Despite, for example, pressure from several US legislative efforts after 1989 calling for environmental reform within the IMF (Horta, 1996), the message from its Managing Director has been that: "In addressing the specific issues of the environment, we rely basically on the expertise of our sister institution the World

⁷⁸ The difficulties and problems associated with evaluating the effect of the SAPs on the economy, as has been identified in Chapter 3, are applicable in evaluating the environmental impact of the SAPs as well. For more comprehensive discussion on these difficulties associated with the evaluation of the environmental impact of the SAPs, see: Panayotou and Hupe, 1996.

Bank.”⁸⁰ This statement seems somehow contradictory with the recent recognition within the IMF staff of the important linkage between the macroeconomic policies and the environment⁸¹. As far as the World Bank is concerned, on the other hand, it has begun to pay some limited attention to the environmental aspect of its SAPs. For example, of the 34 adjustment operations approved in fiscal year 1989, 7 contained conditions directly related to environmental management (Webb and Shariff, 1992). Nevertheless, structural adjustment lending is exempted from the environmental impact assessments⁸². Considering the increasing importance of structural adjustment lending in the 1980s and 1990s, as mentioned earlier, this exemption can result in a negative impact of the overall operations of the World Bank Group on the environment, notwithstanding its involvement in co-managing GEF with the UNEP and UNDP.

As has been pointed out in the preceding section, the existing operations of the BWIs are affected by the treaty obligations under the climate change regime. This development will no doubt strengthen the previous call for the reform of the SAPs. From the perspectives of all the major groups — the institutions, developed countries and developing countries — the BWIs conceivably need to bring their operations in line with the treaty obligations of the FCCC and Kyoto Protocol, or at least to avoid activities that might run counter to the objectives of the FCCC. To put this policy consideration into action, reforming the design of the SAPs would undoubtedly be a good start. The

⁷⁹ For example, it has been suggested that: “structural adjustment programs, even though they are intended to create an appropriate policy framework for long-term growth, also omit crucial environmental safeguards.” (Cruz and Repetto, 1992.)

⁸⁰ The message is addressed by Michel Camdessus, the Managing Director of the IMF, to the UN Conference on the Environment and Development in June 1992.

⁸¹ For example, the First Deputy Managing Director of the IMF Stanley Fischer noted at an IMF-sponsored seminar on the environment in May 1995 that, “excessive exploitation of natural resources can give rise to structural balance of payments problems and reduce economic growth prospects.” (IMF, August 1996, p. 263.)

primary objective of a SAP is to correct the structural problems in the economy of the borrowing country. The main purpose of the BWIs is not, after all, to assist the implementation of the FCCC. Thus, economic theories and models that are employed to improve the economic situation in the borrowing country will still dominate the basic ideology behind the design of the SAP⁸³. As a result, it seems more plausible to design a “filter” in the SAPs for climate change purpose to leave out negative impact on climate change. Such an action has already had precedent in the current operations of the SAPs: the practice of “social safety net”.

At present, “social safety net” has been incorporated in some of the programmes under either the Bank or the Fund⁸⁴. Some of the measures have been identified as rather common in the design of social safety net, such as targeted subsidies, improved distribution of essentials such as medicines, temporary price controls for essential commodities, and adaptation of permanent social security arrangements to protect the poorest (IMF, 1995). This demonstrates the flexibility and possibility of the staff of the BWIs to design a “climate safety net” by incorporating factors that might mitigate the negative impact on climate change. The following discussion will then look at ways in which a “climate safety net” could be adopted in the SAPs. Note that the following

⁸² Operational Directive 4.01 on Environmental Assessment of 3 October 1991 states, in part: “For the purpose of this directive, environmental assessment covers *project-specific* and other environmental impacts in the area of influence of a *project* ...” (emphasis added.)

⁸³ It is, of course, possible to advocate for a complete shift of the economic theories and models behind the design of the SAPs by, for example, proposing formal amendment to the Articles of Agreements in order to take on “sustainable development” as one of the purposes of the BWIs. In which case, the design of the SAP will be based completely on the sustainable development model. Nevertheless, reform on such a grand scale seems rather impractical considering, for example, the cumbersome amendment procedures set down in the Articles of Agreement. Therefore, the present study will try to make modest, but workable suggestions as is discussed in this section. More discussion follows in the main text.

⁸⁴ Note that it is not yet ascertain that “social safety net” has become a standard practice in the SAPs. It is even yet to be established that the “social safety net” has already changed the perception of the management of the IMF. For example, in a recent report on the experiences of the Fund’s social safety net, it is stated that: “The IMF’s involvement in social issues has to be seen in the context of its mandate ...

recommendations are by no means comprehensive or effective in terms of the impact on climate change. It merely presents some alternative options the BWIs can take up in reforming their SAPs.

The most relevant elements in the SAP affecting the implementation of the FCCC are likely to be, *inter alia*, pricing mechanism and subsidy reform, public expenditure policies, and trade liberalisation. Pricing reform is probably the most fundamental proposal for environmental sustainability in almost all sectors of the economy (Williams, 1995).

Among the pricing reform, the energy sector must receive the first and foremost attention for both economic and environmental purposes. On the economic front, energy prices often do not cover their true economic costs, including the externality costs to the environment in most developing countries. This often means that consumers are not paying the prices that encourage them to use energy efficiently and select the right form of energy and energy-saving equipments for their needs (Churchill and Saunders, 1991). On the environmental front, the energy sector needs to be re-examined as well if the domestic policies of any Parties are to be brought in line with the objectives of the FCCC⁸⁵.

In the present operations, pricing reform has become a standard element in the SAPs. In the evaluation conducted by the World Bank on the implementation of conditionality in the SAL/SECAL, the policy areas where implementation has been most successful are those involving changes in prices, including energy prices (World Bank, 1988a). In the process of pricing reform, the elimination of energy subsidies serves both

given [its] essentially macroeconomic mandate, the IMF's contribution to social development is mainly indirect, and its role in social policy advice is necessarily limited." (Chu and Gupta, 1998, p. 3.)

economic and environmental purposes. Removing energy subsidies relieves the government of an unnecessary public expenditure. It enables the energy price to reflect its true market value as well, which stops the consumers to over-consume the under-priced energy sources, in particular non-renewable energy sources such as fossil fuel. Although pricing reform is identified as one of the more successful policy area where the implementation of conditionality is the strongest, “energy subsidies”, according to another World Bank report on the experiences of adjustment lending, “received scant attention in conditions on adjustment lending”⁸⁶ (Huther, Roberts, and Shah, 1997, p. 33). The same report also recognises that, “the limited data on subsidy reductions indicate that though expenditures on subsidies were often reduced in response to conditions, the reductions are often not sustained”⁸⁷ (Huther, Roberts, and Shah, 1997, p. 33).

Energy subsidies can be granted to various energy sources, including renewable ones. A traditional SAP would have all forms of energy subsidies removed. By adopting a “climate safety net”, however, subsidies granted to renewable energy sources could be maintained. For example, if the borrowing government is receiving a GEF grant and subsidy is granted to renewable energy, such form of energy subsidy would not be

⁸⁵ For example, “energy” is listed first in the Sectors/source categories in the Annex A to the Kyoto Protocol which sets down the types of GHGs that are subject to the reduction timetable.

⁸⁶ Another World Bank report in 1995 looks at the experience of SAL/SECAL during 1980-92 (Jayarajah and Branson, 1995). This report has a specific chapter examining the energy sector. 65% of the adjustment operations feature substantial energy conditionality (21 out of 32 adjustment operations are under review). According to the Bank’s evaluation, satisfactory results in terms of programmes success and sustainability are identified. Limitations of the adjustment operations in the energy sector, however, do have been pointed out and recognised as well in this evaluation.

⁸⁷ When looking at these two World Bank reports on the experiences of adjustment lending, one has to pay attention to the year when the reports were conducted. The 1988 report on the evaluation of the SAL/SECAL examines the adjustment loans made before fiscal year 1988; while the 1997 report looks at the adjustment loans made more recently. The problem of insufficient attention to the energy subsidies is identified in the later report. This demonstrates that the problem is still prevailing in the SAL/SECAL operations of the World Bank as recently as in 1997.

removed under a SAP with a climate safety net⁸⁸. Similar operations have already been in place in the IMF programme with a social safety net. For example, under the IMF programme with a social safety net, food subsidies in general will be removed, except for those specifically targeted at the poorest group (IMF, 1995). As a result, it will not be unprecedented if a climate safety net is adopted to differentiate different types of subsidies. It is, thus, suggested that the World Bank, in designing a SAP, should adopt a more consistent approach toward pricing reform in the energy sector and the elimination of energy subsidies, in particular subsidies to fossil fuel. Although the IMF usually deals less with sectoral issues in its ESAF conditions, its mandate does not preclude it from bringing such issues to the attention of the borrowing governments in discussing any necessary policy reform⁸⁹. Furthermore, the IMF and the Bank could also ensure that such issues would be properly addressed in the Policy Framework Papers they assist the borrowing government to prepare⁹⁰.

The climate safety net in this context has its potential problems, however. For example, how can the BWIs and the borrowing government distinguish “climate friendly subsidy” from “climate unfriendly subsidy”? Another potential problem is that, subsidy that passes through the “climate filter” and remains in place consequently might later be challenged under the WTO regime where certain types of subsidies are prohibited. Nevertheless, all these potential problems should not overshadow the potential gain a climate safety net can achieve.

⁸⁸ The subsidy the BWIs seek to remove might arguably be different from subsidy granted under an international body such as GEF. However, both involve giving money to a specific industry or commodity in order to lower the true cost. As the discussion of the differences between the two is beyond the scope of the study, both forms of subsidy will be regarded the same in this chapter.

⁸⁹ Pricing reform and the elimination of subsidies form no small part of the public expenditure reform of a government. The conditionality laid down in an ESAF usually requires such reform.

Another common element in a SAP is the requirement to cut down government expenditure. Under the FCCC, all Parties, including the developing country Parties, are committed to prepare a National Communication containing various types of information and describing policies taken to implement the Convention (FCCC, Article 12). This commitment demands adequate resources for the domestic environmental agency to implement. As domestic environmental agencies in developing countries are usually rather weak, their budget is highly likely to be affected when government expenditure reform is required. The climate safety net recommended should be able to help the borrowing government to identify what kind of fundamental environmental services, including its treaty obligations under the FCCC, are to be maintained. Under the FCCC, developing countries are entitled to seek financial resources to meet the “agreed full costs” from developed countries in complying with obligations to submit National Communications. In addition, the developing countries are eligible to apply to GEF for funding in the process of preparing the National Communication⁹¹. This, however, does not give the government an excuse to relieve itself from the responsibility of devoting adequate resources in undertaking commitments under the FCCC. Furthermore, National Communication is not the only national programmes Parties to the FCCC are to formulate. The climate safety net can help to identify resources required in formulating and implementing programmes that are unable to receive funding from GEF.

As for the element of trade liberalisation in the SAP, comprehensive suggestions will be more difficult to offer. One of the purposes of the SAP, and indeed of the BWIs,

⁹⁰ A recently published PFP, one prepared by the Former Yugoslav Republic of Macedonia as a prerequisite to its application of an ESAF, does incorporate energy sector in its medium-term programme for 1998-2000.

⁹¹ This falls under the category of “enabling activities”, one of the three categories as described in GEF Operational Strategies. It is also under a speedier disbursement process, as has been requested by the COP to the FCCC (FCCC/CP/1996/L.9).

is to encourage the liberalisation of international trade. By doing so, the borrowing government is expected to earn foreign exchange and to achieve long-term growth. Liberalisation of international trade usually requires the government to lower import tariff and to promote export. At the moment, the FCCC and the Kyoto Protocol do not set down trade restrictions similar to those in the 1987 Montreal Protocol. Theoretically, thus, the design of a SAP with respect to trade liberalisation does not affect the Parties to the FCCC. Nevertheless, various aspects relating to trade liberalisation do have impact on the ability of the government to implement the FCCC. For example, for an energy-importing country, lowering the import tariff of various energy sources can have different implications to its FCCC commitments. If the import tariff of petroleum is reduced to such a level that does not reflect its true costs⁹², it might lead to over-consumption. On the other hand, if the government chooses to lower the import tariff of natural gas, it can help to reduce the emission of CO₂. Other examples can be observed in countries that are rich in fossil fuel resources. If the government has an incentive to increase its export of, for instance, petroleum, by lowering the price to a level that does not reflect its true value, it might end up encouraging other countries to over-consume and result in an overall increase of GHGs emissions on a global scale.

As has been illustrated, element of trade liberalisation in the SAP does affect a country's ability to implement the FCCC. It needs to be pointed out that the BWIs do not and should not engage in constructing the government's international trade regime, such as what types of commodity should have a lower import tariff than the others have. However, the BWIs can assist the government in the process of trade liberalisation by providing advice on the the sequence and priorities of trade liberalisation.

⁹² The true cost of fossil fuel should take into account its local and global environmental externalities,

The aforementioned suggestions are by no means comprehensive. They are some of the possible ideas the BWIs can consider when designing a climate safety net of the SAP⁹³. Note that none of the suggestions is easy to implement and each of them requires thorough research to ascertain the impact on the borrowing government. In addition, with the application of the “old-style” conditionality associated with SAPs, imposing these ideas on the borrowing developing countries might provoke resentment. However, these suggestions can take the form of policy advice, which do not necessarily take the form of “loan conditions” in the sense that failure to comply will result in suspension of loans. It might be argued that the effectiveness would be diminished if these suggestions carry no legal implications since governments could afford to ignore them. On the other hand, however, being flexible can soften the harsh image conditionality generate. In any case, the government bears the ultimate responsibility of designing and implementing domestic policies that are compatible with the FCCC. It is sufficient that the BWIs provide the correct incentives and policy advice when assisting their developing country members undergoing the process of structural adjustment. Furthermore, since the borrowing countries themselves are Parties to the FCCC, they have the responsibilities to comply with the FCCC. Therefore, the policy advice in the SAP with a climate safety net, designed with climate change concerns in mind, have a better chance to get implemented by these borrowing governments.

It is not yet certain whether the practice of “social safety net” has achieved its objectives. By the same token, a climate safety net can not guarantee to solve all the problems associated with the operations of the SAPs and enable the BWIs to assist their

rather than referring merely to its market price.

⁹³ One criticism relating to the climate safety net might be that it would lead to a proliferation of conditionalities. Nevertheless, as can be seen from the previous discussion, a SAP with a climate safety

developing country members to implement the FCCC. It nevertheless provides a better and more feasible option for the BWIs to begin reforming their operations in the light of treaty obligations under the climate change regime. In addition, an encouraging sign can be seen from the more recent Policy Framework Papers published by the borrowing governments in which environmental factors have been taken into account. In the Letter of Intent submitted by the Indonesian government in July 1998, environmental conditions have also been incorporated⁹⁴. These developments demonstrate that the BWIs have already begun to pay more attention to the environmental impact of their programmes, which might enable the design of climate safety net being adopted more easily.

5.4 Evaluation of the innovative mechanisms

The previous section examined how the existing mechanism of the BWIs can be reformed in the light of the FCCC and the Kyoto Protocol. The SAPs are not the only operation of the BWIs that are affected by the development under the climate change regime. The development of the World Bank's innovative mechanisms, as has been pointed out, can also be affected by the FCCC and the Kyoto Protocol. Hence, this section will conduct a brief evaluation of the innovative mechanisms of the World Bank that are designed for a specific purpose: to facilitate the implementation of the FCCC and the Kyoto Protocol.

net, rather than add on more conditionality, requires a re-design of the existing conditionality. Therefore, it does not necessarily incorporate more conditions than the existing SAPs do.

⁹⁴ For example, PFPs published in 1998 by the governments of Mali, Central African Republic, Cameroon, Republic of Mozambique, Uganda, and Malawi all contain sections referring to environmental policies. All these documents can be found at the official website of the IMF at: <http://www.imf.org>.

Among the three innovative mechanisms introduced in the present study (Chapter 4), GEF⁹⁵ and the Bank AIJ programme have become operational while the GCI/PCF is still under preparation as of March 1999. The evaluation conducted in the following will look at the governance structure of these mechanisms and its implications to the relationship between the World Bank and its developing country members. In addition, the relationship with the FCCC will also be investigated. In relation to GEF, this issue will be examined in the context of “mainstreaming”⁹⁶ which, in combination with its governance structure, bears implications to the relationship between the Bank and its developing country members. In relation to the AIJ and GCI/PCF, the relationship with the FCCC is more difficult to evaluate since no formal relationship has been established as has been done in the case of GEF. Thus, this issue will be examined in the context of “possible” relationship with the FCCC and whether it is in the interests of developing countries that such relationship should be instituted.

GEF has commissioned two independent external evaluation teams to evaluate the performances of its pilot phase (1991-94, GEF P) and the first three-year (1994-97, GEF I) operations after its restructure in 1994 (UNDP, UNEP and World Bank, 1994; GEF, March 1998). The following evaluation will be based largely on these two independent evaluation reports⁹⁷. The World Bank AIJ programme has had rather limited experiences in terms of projects undertaken and the number of participants. Therefore, its evaluation will be difficult to carry out⁹⁸. The following discussion can only examine the governance structure of the present World Bank AIJ programme that is laid down in the

⁹⁵ Unless otherwise specified, the term “GEF” used throughout this section includes GEF P and GEF I.

⁹⁶ “Mainstreaming” refers to how the operations of GEF have influenced the regular operations of its Implementing Agencies.

⁹⁷ Due to the limited resources and time frame of the thesis, it is impossible for the present study to carry out its own large-scale evaluation of GEF.

official documents related to the AIJ programme produced by the Bank⁹⁹. As for the GCI/PCF that is not yet operational, the basis of the following discussion will be similar to that applied in the AIJ programme. That is, the official documents from the Bank in relation to the establishment of the GCI/PCF and its future operations¹⁰⁰.

5.4.1 Governance structure and relationship with the developing countries

5.4.1.1 GEF

The assessment of the decision-making structure was not in the terms of reference in either of the two independent evaluation report. As for the relationship between the World Bank and the developing countries, only GEF P evaluation report has touched upon similar issue very briefly¹⁰¹. Institutional issues have been addressed. However, the dynamics of power structure in the GEF Council, with its novel design of decision-making process after the restructure, and the recipient countries' perceptions of this governance structure are addressed in neither of the reports¹⁰². GEF P evaluation report comments that: "The influence of recipient countries on the type and substance of individual projects implemented in their countries is far lower than it may appear from publicly available documents." (UNDP, UNEP and World Bank, 1994, p. 12.) This is understandable in the operations of GEF P since most of the policies and procedures adopted during the pilot phase were mainly based on those of the Implementing

⁹⁸ Even the Bank itself has not carried out a full evaluation as to the performances of its AIJ projects and programmes.

⁹⁹ These documents include, for example, World Bank, May 1997a, November 1997a. All these documents can be found on the website: <http://www-esd.worldbank.org/cc>.

¹⁰⁰ These documents include, for example, World Bank, May 1997b, August 1997, and November 1997b. All these documents can be found on the website: <http://www-esd.worldbank.org/cc>.

¹⁰¹ This issue is not included in the terms of reference in GEF P evaluation report. It is analysed in the context of a general introduction, in which the expectations of GEF P is discussed from the donors' and the developing countries' perspectives. See: UNDP, UNEP, and World Bank, 1994, pp. xii-xiii.

¹⁰² Unsuccessful attempts were made to interview those GEF Council Members who at the same time serve on the World Bank Executive Board during the author's field trip to Washington DC.

Agencies, one of them the World Bank. It seems fair to conclude that, the relationship between the Bank and the developing countries remained somehow adversarial in GEF P, as the input from the developing countries was minimal. In terms of agenda setting, GEF I is required to seek and follow the guidance of the two Conventions to which GEF serves as the interim financial mechanism. At their respective COPs, in which the developing countries are better positioned to voice their environmental and developmental priorities, the two MEAs adopted their respective guidance to GEF. GEF I concluded that: "The study team found that GEF has sought and strictly implemented the guidance of the conventions with due regard for GEF's own mandate and funding limitations." (GEF, March 1998, para. 343.)

As far as agenda setting is concerned, hence, the recipients, ie the developing countries, managed to claim a greater degree of influence over the restructured GEF. This, however, does not corroborate that the relationship between the World Bank and the developing has been improved. Nevertheless, the restructured GEF does carry with it a set of decision-making procedures in which the recipients can participate more actively. In addition, the GEF I evaluation report has identified traces of improvement and noted that: "GEF working relationships within the World Bank are somewhat analogous to those between the World Bank and the recipient countries, with a tendency for GEF activities to become 'donor driven' ..." (UNDP, UNEP and World Bank, 1994, p. 134.) In GEF I, the evaluation report concludes that GEF I activities become less "donor driven", resulting from clearer mandates emanated from Operational Strategies and Operational Programmes. Thus, GEF's working relationship within the Bank has improved after the restructure. Considering the similarity between GEF working relationships within the Bank and those between the Bank and the recipient countries,

this improvement can shed some light on the World Bank in re-examining the approaches used in dealing with its developing country members.

5.4.1.2 Joint implementation-related mechanisms: AIJ and GCI/PCF

There is no formal governance structure in the current Bank AIJ programme. This is understandable considering the nature of the current Bank AIJ programme, which is essentially a bilateral one between the host governments and Norway¹⁰³. After JI¹⁰⁴ among Annex I Parties was formally sanctioned by the Kyoto Protocol, and after the AIJ polite phase under the FCCC began to cumulate more experiences, the Bank AIJ programme has now the potential to attract more participants. That might lead to a formal link being established with the FCCC and the Kyoto Protocol, as has been discussed in the Chapter 5.2.3. If that is the case, the governance structure of the Bank AIJ programme will play a more significant role as its operations will affect developing countries' access to this pool of resources in carrying out projects related to climate change¹⁰⁵. If the Bank AIJ programme develops into a more formal mechanism similar to GEF, the governance structure of GEF might provide a good precedent.

As for the relationship between the Bank and its developing countries members, the limited operations of the Bank AIJ programme make it difficult to ascertain the impact the AIJ programme have had on the operations of the Bank at large and on the relationship between the Bank and its developing country members. The pilot projects under the Bank AIJ programme are expected to be implemented in conjunction with

¹⁰³ For further discussion on the origin, development and operations of the Bank AIJ programme, see Chapter 4.1.2.2.

¹⁰⁴ As has been discussed previously, JI under the Kyoto Protocol refers to collaboration between Annex I Parties only.

¹⁰⁵ More discussion on this potential relationship with the FCCC will be conducted in the succeeding subsection.

other World Bank Group investment projects. From this perspective, it seems arguable that the Bank AIJ programme will be influenced by the regular operations of the Bank, rather than vice versa. The Bank has drawn up a set of project selection criteria and evaluation guidelines for its AIJ programme. These criteria and guidelines are consistent with the objective of the FCCC. However, it remains unclear whether these criteria and guidelines are drawn up in consultation with the developing countries. The AIJ under the FCCC is bilateral in nature while the Bank AIJ programme inevitably has certain input from the Bank. Since these criteria and guidelines are already in place, any future collaboration between other donors and the Bank in setting up similar AIJ programmes will most likely follow these criteria and guidelines in the first instance. The current design of the Bank AIJ programme, the one in collaboration with Norway, has only limited, if any, input from the developing countries¹⁰⁶. It can be improved in the following aspects. Further project selection criteria and evaluation guidelines will need to follow the guidance from the COP to the FCCC¹⁰⁷, as in the case of GEF operations. In addition, the Bank is encouraged to consult with developing countries that show interests to be potential hosts to any AIJ programme in the process of setting out these criteria and guidelines, including methodological issues in implementing these projects. Both of suggestions can complement any future governance structure the Bank AIJ programme might develop in tending to the need of the developing countries in implementing the FCCC.

¹⁰⁶ In the relevant documents relating to the Bank AIJ programme, it is stated that: "The Bank AIJ program is coordinated by a small team within the Global Environment Division [of the Bank] which also relies heavily on input from staff members throughout the Bank." (World Bank, May 1997a.) The relevant documents do not indicate the involvement of the developing countries in the process of formulating project selection criteria and evaluation guidelines.

¹⁰⁷ Or MOP to the Kyoto Protocol, which will be the supreme body laying down the operational procedures and criteria for the JI operations of the Kyoto Protocol.

As for the GCI/PCF, evaluation relating to its governance structure can not be conducted at the moment since it is not operational yet. As has been discussed in Chapter 4, the PCF is likely to become another trust fund administered by the Bank. The role of the Bank as its trustee will depend on any possible link the PCF might have with the CDM under the Kyoto Protocol in the future¹⁰⁸. The Bank plans to make its investments in projects funded by the PCF on the basis of “Project Selection Guidelines”, which will, according to the Bank, be developed in consultation with the participants and hosts (World Bank, 1998b). This is an encouraging step which the Bank intends to take in terms of providing a more collective decision-making process. The Bank’s Executive Directors from developing countries are said to be very supportive and interested in the development of the GCI/PCF, especially the decision-making structure of the GCI¹⁰⁹. However, the work on setting up the GCI/PCF so far is basically prepared by the Bank’s GCI team. In addition, as the private sector is envisaged to play a large role in the PCF, the Bank does not favour GEF Assembly type of structure as the model for the GCI/PCF¹¹⁰. As a result, whether the Guidelines will have equal inputs from the investors as well as the developing countries as hosts remain uncertain.

5.4.2 Relationship with the FCCC and the Kyoto Protocol

5.4.2.1 GEF: the issue of “mainstreaming”

The importance of “mainstreaming” the regular operations of the World Bank for global environmental benefits has been reiterated in the New Delhi Statement adopted at

¹⁰⁸ More discussion on the potential relationship between the GCI and CDM will be conducted in the succeeding sub-section. For further discussion on the development of the GCI/PCF, see Chapter 4.1.2.2.

¹⁰⁹ Personal communication with a staff member of the World Bank.

¹¹⁰ Personal communication with a staff member of the World Bank.

the first GEF assembly in April 1998¹¹¹. The task of “mainstreaming of the global environment by Implementing Agencies” has nevertheless been identified as unsatisfactory by both GEF independent evaluation reports¹¹². In GEF P, the influence was rather from the Bank to GEF than vice versa. From the beginning of selecting the four focal areas, GEF P is founded on the existing policies and procedures of the Implementing Agencies. As the GEF P evaluation report points out: “GEF working relationship within the World Bank are somewhat analogous to those between the World bank and the recipient countries, with a tendency for GEF activities to become ‘donor driven’ ... GEF has suffered from being treated as either an add-on or a minor sideline to the World Bank’s regular lending ...” (UNDP, UNEP and World Bank, 1994, p. 134.) This hardly proves that the objective of mainstreaming the global environment into the operations of the World Bank through its involvement in GEF P has been achieved. On the contrary, it seems to suggest the opposite that, the Bank was using GEF P as a “window dressing” to its normal operations and the involvement in GEF P brought no impact on the regular Bank operations at all.

In GEF I, clearer Operational Strategies and Operational Programmes have been adopted by the GEF Council following the guidance from the COPs to the FCCC and the CBD. With a clearer mandate, GEF I should be able to rid the “shadow” of the Bank and act as a “Trojan horse” in mainstreaming the global environment into the operations of the World Bank. Nevertheless, the GEF I evaluation report still concludes that: “Overall, the team found that, although the World Bank’s co-financing of GEF projects is a

¹¹¹ It is stated that: “GEF Implementing Agencies should promote measures to achieve global environmental benefits within the context of their regular programs and consistent with the global environmental conventions while respect the authority of the governing bodies of the Implementing Agencies.” (New Delhi Statement of the First GEF Assembly, para. 9.)

¹¹² The same observation has been pointed out by other commentators. See, for example, Fairman and Ross, 1996.

significant accomplishment in mainstreaming the global environment, it has fallen well short of its potential for mainstreaming.” (GEF, March 1998, para. 266.)¹¹³ The conclusions reached in two evaluation reports coincide with the conclusion of the present study that environmental issues, including global environmental issues, have not been incorporated into the design of the Bank’s SAPs¹¹⁴, an important part of its operations.

In a report prepared by the World Bank to the Executive Board and the GEF Council Meeting in October 1998 regarding “mainstreaming the global environment in the World Bank Group operations”, it is identified that: “The compatibility of the Bank Group’s broader project portfolio with the Bank-GEF objectives for global environmental management has been raised by some as an issue. Specifically, it has been questioned whether continued Bank lending for GHG intensive fossil fuel-based energy projects is consistent with the Bank-GEF objective to promote climate-friendly energy technologies.” (GEF, October 1998, p. 15.) In responding to this concern, the Bank states that “it is important to note that the Bank’s primary mission is to reduce poverty and promote economic development” (GEF, October 1998, p. 15) and does not seem prepared to phase-out operations of this kind that are incompatible with the FCCC. Recalling the interaction between the BWIs and the FCCC, as discussed in Chapter 5.2.2, the current operations of the Bank apparently has not taken into account the objective of and obligations under the FCCC and Kyoto Protocol. Whether this practice of the Bank is incompatible with its OMS 2.36, which requires the Bank not to finance projects that might contravene any international environmental agreement to which the member

¹¹³ The evaluation team has identified the following aspects of the Bank’s operations in which efforts of mainstreaming are needed. These include, inter alia, lack of attention to the energy lending strategy, inadequate budget for the global overlays programme, lack of incentives to the staff to encourage or manage projects with global environmental benefits, and lack of global environmental issues in the Country Assistance Strategies documents (GEF, March 1998, paras. 219-270).

¹¹⁴ See Chapter 5.3.1 for further discussion.

country concerned is a party, deserve further observation. For example, cases might arise where affected citizen in a country where the Bank is funding a coal-powered plant decide to make a complaint to the Inspection Panel alleging the Bank's breach of this particular provision under the OMS 2.36. What will then be the decisions of the Inspection Panel remains uncertain. In any case, it seems, under its current operation, the World Bank still has some way to go in truly mainstreaming the global environment into its overall operations.

5.4.2.2 J-related mechanism: AIJ and GCI/PCF

At the moment, both the JI-related mechanisms within the Bank do not have formal link with the FCCC and the Kyoto Protocol. However, as JI is officially sanctioned (Article 6) and other JI-related implementation tools are provided for in the Kyoto Protocol¹¹⁵, the Bank AIJ programme might attract more attention from donor as well as host countries. As interest from other countries in establishing a similar collaboration with the Bank increases, and as the AIJ pilot phase is better developed within the FCCC, the Bank AIJ programme has the potential to step up its scale and to transform into another potentially influential mechanism of the Bank to assist domestic compliance of the FCCC in its developing country members.

As for the other JI-related mechanism, the GCI/PCF, no assessment and evaluation are available for it is not yet operational. The PCF under development now has not yet had any formal link with the FCCC. As discussed in Chapter 4, the relationship between the GCI/PCF and the CDM of the Kyoto Protocol remains to be seen. The legal framework for the PCF would be similar to that of a World Bank trust

fund. Since the potential investors in the PCF include public and private participants, and there is no formal link between the PCF and the FCCC at the moment, the Bank's role as a trustee in the PCF trust fund is expected to be different from that in the GEF Trust Fund. If a formal agreement between the PCF and, for example, the CDM is established, it will then be expected that the Bank as a trustee needs to be accountable to the COP serving as the Meeting of the Parties (COP/MOP) to the Kyoto Protocol.

This scenario will be a positive development of the GCI/PCF as the needs of the developing countries can be better reflected via the COP/MOP to the Kyoto Protocol. In fact, as argued in Chapter 5.2.3, it seems advantageous to both developed and developing countries that a formal link with the FCCC is to be established. In that case, arrangement similar to that of GEF might be expected between the GCI/PCF and the FCCC and/or Kyoto Protocol. This, as in the case of GEF, will have positive influences on the operations of the Bank. In the meantime, before such arrangement is reached, developing countries are encouraged to take a more active role in participating in the design of the GCI/PCF. The Bank, in drawing up guidelines for projects funded under the PCF, will be expected to follow its own policy that requires consultation with both the participants and the hosts. The GCI/PCF that comes into operations will be beneficial to both the investors and the hosts, while bring positive lessons to the operations of the Bank at large.

In summary, it is difficult to have a conclusive evaluation on these innovative mechanisms of the World Bank. In the case of GEF, the overall operations, in particular those of GEF I have proved to be encouraging and improving. With regard to the new governance structure of GEF I, developing countries have the opportunities to participate

¹¹⁵ For example, the CDM provided in Article 12 and emission trading provided in Article 17 of the Kyoto

in the design of conditionalities GEF might employ. This might gradually help to improve the relationship between the Bank and its developing country members, which, in turn, might increase the effectiveness of the GEF in achieving its objectives. In the meantime, the IMF can learn valuable lessons as to how international financial institutions can achieve a better working relationship with the recipient countries. As the International Expert Advisory Panel for the the GEF I evaluation report correctly points out: “The Implementing Agencies, in carrying out the GEF mandate, may also need to re-examine the potential for influencing their other partners, *such as the International Monetary Fund*” (emphasis added) (GEF, March 1998, Annex II: Report of the International Expert Advisory Panel for the Study of GEF’s Overall Performance, January 1998).

With regard to “mainstreaming” the regular operations of the Bank, more improvements will need to be made if the Bank is to comply with its own policy statement that it will not finance activities that contravene its borrowers’ international obligations. As for the JI-related mechanisms, evaluations as to their governance structure can not be conducted yet due to a limited experience. However, as both of these mechanisms are created to assist the implementation of the FCCC, some form of cooperation, or formal link with the Convention and the Protocol could be expected. The COP to the FCCC, or the COP/MOP to the Kyoto Protocol, represent a collective decision-making body where developing countries can voice their priorities and needs. To have the JI-related mechanisms follow the guidance from the COP, rather than to leave it to the discretion of the Bank, the interests of developing countries as hosts to projects funded under these mechanisms might be better served.

Protocol. For more information on these mechanisms, see: Missfeldt, 1998.

CHAPTER 6: SOUTH-EAST ASIA: A CASE STUDY

The thesis has so far suggested that governance structure is one of the crucial elements for the effectiveness of the legal and quasi-legal tools employed by the BWIs to influence developing countries. The implications of the FCCC and the Kyoto Protocol on the operations of the BWIs have also been investigated. This chapter will conduct a brief case study on a special group of developing countries to test the arguments presented in the present study. South-east Asian countries, albeit a very heterogeneous group, share similar experiences in terms of “economic” development, the traditional model of “development” advocated and supported by the BWIs.

The first section of this chapter will look at the process of “development” in South-east Asia after WW II and up until the financial crisis in 1997–98, and the role of the BWIs in this process. From this section, the imprint of the BWIs on the domestic policies of these countries will try to be identified. As argued in Chapter 5, the traditional model of “development” advocated by the BWIs has led to the adoption of policies that contribute to the emissions of GHGs. This will be echoed by examining the environmental impact of South-east Asia’s “development” on climate change, which will be conducted in the second section of this chapter. Since the model of “development” promoted by the BWIs might have impeded the South-east Asian governments’ abilities to implement the FCCC, the last section of this chapter will investigate the potential of the innovative mechanisms of the Bank in advancing the objectives of the FCCC in South-east Asia.

6.1 Economic development after WW II and the BWIs' role

6.1.1 *From import-substitution to export-oriented industrialisation*

South-east Asia has some of the fastest growing economies among developing countries in the 1980s and in the 1990s. This section will briefly delineate the development strategies of these countries after the WW II and their economic achievement at this stage. A loosely structured regional organisation in this geographical area is the Association of South-East Asian Nations (ASEAN) of 1967¹. Among the present nine members, only four, Indonesia, Malaysia, the Philippines and Thailand, will be the subjects of the present discussion².

The four South-east Asian countries at the centre of this discussion differ from each other in terms of, for example, economic and political structure, natural resources, and the extent to which they receive external assistance, financially and technically, from the international institutions, in particular the IMF and the IBRD³. However, they share various similarities in terms of their post-war development strategies. Hence, rather than focusing the discussion on individual countries, this section will concentrate on the different development strategies at different stages of their economic development since these strategies are similar in many ways. References to individual countries will be made either as an example or as an exception.

¹ The founding members of ASEAN are Indonesia, Malaysia, the Philippines, Singapore, Thailand and Brunei. Vietnam was admitted in 1995 and Myanmar (Burma) and Laos were admitted in 1997. The membership for Cambodia was delayed due to a coup in 1997 that brought political turmoil to the country.

² The economic development of Singapore is the most advanced among ASEAN and has traditionally be categorised as one of the "Asian newly industrialised countries (NICs)", ie Hong Kong, Singapore, South Korea, and Taiwan. It has different development stages from those of other ASEAN members. Brunei is a relatively small economy that depends largely on its oil export, and, hence, is different from other ASEAN members in this respect. Vietnam is essentially a socialist economy, which is different from other capitalist economies in ASEAN. As for Myanmar and Laos, both of them still suffer from political instability, have relatively close economies compared to other ASEAN members, and, therefore, are different from the four countries in the present discussion. For these reasons, "South-east Asia" will be referring only to Thailand, Malaysia, Indonesia, and the Philippines, when the term is used throughout the discussion.

³ For example, in one research carried out by the Overseas Development Institute, the adjustment experiences of the Philippine and the interaction between the Marcos government and the BWIs have been

6.1.1.1 Post-war period until the 1970s

Each of these four countries, except Thailand, was subjected to colonial rule after the 19th century⁴. As a result, when South-east Asia was opened up to international trade and foreign investment in the late 19th century, the expansion in the exports of primary products was the principal means for economic development (Myint, H, 1972). Even after their independence⁵, a larger proportion of the exports were still primary commodities, with timber, mineral fuels and mineral ores subjected to the greatest demand on the international market. For example, in Indonesia, exports of mineral products, especially petroleum, expanded considerably in the 1950s (Mangkusuwondo, 1975); in Malaysia, the combined exports of rubber, tin and iron ore amounted to 86.6% of its total export in 1950, remained at 84.6% in 1960, and was still as high as 66.1% in 1970 (Arudsothy, 1975); in Thailand, teak exports increased greatly in late 1940s and early 1950 (Chomchai, 1975); and, in the Philippines, exports of logs and lumber were more than 20% of total export and mineral ores constituted another 20% in 1969 (Castro et al, 1975). In addition to primary goods, the exports of agricultural products were also larger than manufactured goods; and agricultural sector were still accounted for larger share of GDP in all four countries — agriculture accounted for more than 30% of the GDP⁶ in all countries.

Industrialisation was low when the WW II ended, and the manufacture sector

regarded as rather different from those of the other three countries (Thailand, Malaysia, and Indonesia) in the region (Marr, 1996).

⁴ Malaysia was a British colony; Indonesia was a Dutch colony; and, the Philippine was a Spanish colony first, and an American colony following the Spanish defeat to the USA in 1899. For a pre-colonial period, colonial period, and independence movement in the South-east Asia, see, for example, SarDesai, 1989 (2nd ed).

⁵ All of them gained independence after the WW II: Indonesia in 1945, the Philippines in 1946 and Malaysia in 1957.

⁶ This figure is from Ichimura, 1975, and some countries used Net Domestic Product not Gross Domestic Product, in their calculation.

grew slowly in the 1950s and 1960s. Import-substitution policies⁷ have been widely adopted in this region in the two post-war decades. For example, Thailand's strategy of its initial industrial development emphasised import substitution with high protection barriers (Chomchai, 1975). By the early 1960s, import-substitution strategies for industrialisation and manufacturing were at the centre of economy planning in South-east Asia (Robinson et al, 1987). Indonesia was the "closest" of all because of its ideological goals of economic nationalism and socialism during 1950-65. The Indonesian government, for example, increased its quantitative controls over foreign trade and direct state intervention (Myint, 1972). However, Indonesia was not an exception where the role of state was crucial. State involvement in investment and production, along with economic planning, were the prevailing characteristic in the whole region in the 1950s and 1960s. (Robinson et al, 1987)

The economic policies of South-east Asia in the 1950s and 1960s can be summed up as follows: reconstruction after the WW II, the dominant position of primary exports and agricultural sector, limited industrialisation and a small manufacturing sector, and, most important, import-substitution policies.

6.1.1.2 From the 1970s

By the early 1970s, South-east Asia was able to maintain a reasonably high rate of growth and to begin a limited industrialisation. The two oil crises characterised the international economic scene in the 1970s turned out to be the "blessing" for Indonesia and Malaysia because of the massive oil and natural gas export earnings. The availability

⁷ Import-substitution strategies usually take the forms of high import tariff, bans, and quotas, as well as import licensing. They are used by developing countries to protect their industrialisation and resources for the purposes of building its own ability to produce the product and subsequently to foster export trade.

of the so-called “petro-dollars⁸” enabled the others, in particular the Philippines, to borrow heavily from private commercial banks in order to finance the high cost of major investment industries, which were highly protected under the import-substitution policies. This ready availability of international finance capital has provided the means for the South-east Asian countries, except Malaysia which moved into the export-oriented phase in the late 1960s for its growing trade deficits and constricting domestic market, to maintain their import-substitution policies throughout the 1970s (Robinson et al, 1987).

By the early 1980s, the positive external economic environment was under constraint due both to the collapse of world commodity prices and to the contracting international capital market where private funds were no longer easily available. As a result, most of the South-east Asian countries were facing economic contraction throughout the 1980s, partly resulting from the debt accumulation from the 1970s. Indonesia, with more than 80% of its foreign earnings coming from oil and liquefied natural gas by 1981–82, was in the most difficult situation when oil prices collapsed in 1981–82 (Robinson, 1987). The Philippines also experienced hardship, in particular in the first half of the 1980s, as its debt service, measured as a ratio of export earnings, nearly doubled in 1980–82, and the international terms of trade had been deteriorating since 1972 (Fayasuriya, 1987). In Thailand, the continuous inflow of capital throughout the 1970s and early 1980s helped to cushion the worst effects of the world recession. The capital inflow, however, also induced the corresponding increase of foreign debt. As a result, Thailand faced its first major economic crisis by 1985 since the 1950s (Hewison, 1987) Malaysia, with a broader export base and its policies and measures to encourage

⁸ The sharp increase in the price of petroleum in the 1970s brought huge export earnings for oil-exporting countries, and most of these countries deposited large sum of their export earnings in private commercial banks in the US and in Europe. The sudden influx of cash compelled the private commercial banks to

foreign direct investment since late 1960s, was more resilient. Between 1979 and 1981, however, the Malaysia government, in the face of adverse international economic environment, relied heavily upon deficit budgets to sustain high growth. Consequently, it accumulated its external debt in a very short period of time in the early 1980s (Sundaram, 1987).

By the end of 1980s, South-east Asian countries, at varying degrees and at different times, all experienced serious recession and ran into debt problems. The resulting difficult situation has rendered these countries vulnerable to foreign economic policy influence, in particular the IMF and the World Bank (Robinson et al, 1987), which will be examined later. In addition to the increasing influence of the BWIs over South-east Asia, the 1980s also witnessed two other important developments in the region: the export-oriented strategies had been thoroughly adopted throughout the region⁹ and the foreign direct investment (FDI) had been increasing at a phenomenal speed.

As mentioned, the import-substitution policies were at the thrust of economic planning in South-east Asia in the 1950s and 1960s. As the easy phase¹⁰ of import-substitution policies reached its limit by mid to late 1960s, calls were being made for a shift of policy toward a more export-oriented strategy. It is not to suggest that this change of policy separated the history of industrialisation in this region neatly into import-substitution period and export-oriented period. Certain sectors have long before been promoted for export-oriented production, while specific sectors, for example, the heavy industries in Indonesia, were still under extensive protection at the same time. In addition, the pace for this change of policy was not uniform throughout the region. For example, as early as 1968, Malaysia has signalled the strategic switch from import-

recycle these "petrodollars" and made borrowing from these private sources relatively easy and attractive for developing countries in the 1970s.

⁹ Probably with the exception of Indonesia, see: Robinson, 1987.

substitution policy to export-oriented policy in its Investment Incentives Act (Sundaram, 1987). Indonesia, on the other hand, still granted strong protection to a variety of industries in mid 1980s as political, bureaucratic and capitalist interests became intertwined with the continuation of its import-substitution policy (Robinson, 1987). Despite some difficulties facing the South-east Asian countries in shifting toward a more export-oriented strategy¹¹, it is, nevertheless, fair to conclude that, at the end of 1980s, export-oriented strategies have been firmly adopted, and will continue to be adopted throughout South-east Asia¹².

Another significant phenomenon in South-east Asia in the 1980s was the increasing inflow of FDI. Four of the top ten largest host developing countries of FDI were Asian in 1996. The inflow of FDI into the four ASEAN countries increased by 43% in 1996, to an estimated US\$ 17bn (UNCTAD, 1997). That was the result of several policy considerations of private investors and South-east Asian governments. For private investors, in particular multinational enterprises (MNEs), cheap labour costs for their production and new market for their products were constantly in demand. When the rising labour costs in the Asian newly industrialised countries (NICs) were no longer competitive, South-east Asia emerged to provide an alternative for overseas investment of the MNEs. For the South-east Asian governments, FDI seemed to be the ideal form of external financing because not only does it bring in capital as well as technology, FDI, unlike foreign loans, is not subjected to the obligation of repayment in the future. Thus, the South-east Asian countries have adopted various incentives to attract FDI.

¹⁰ That is, the domestic market has reached its saturation point, particularly in consumer goods, and the financial resources available for protecting the infant industries have reached the limit.

¹¹ For example, the very conditions in the 1960s and 1970s that had enabled the export-oriented models, the Asian NICs, to expand their exports were rapidly collapsing in the 1980s due to the prevailing world recession. In addition, fiscal pressures on governments, rising debt levels and balance of payments problems have put constraints on the South-east Asian countries to provide sufficient means to finance projects central to achieving the objectives, i.e. the export-oriented strategies (Robinson et al, 1987).

Furthermore, in order to tap the increasing FDI from the neighbouring countries, ie the Asian NICs and Japan (Guillouet, 1990) and, in particular after the 1990s, to cope with the rise of a competitive China, (Nomura Research Institute et al, 1995) the governments in South-east Asia became even keener to adopt a number of policies for promoting FDI via favourable treatment. For example, the restrictive attitude toward FDI adopted by the Malaysian government in the 1970s and early 1980s has transformed into an active promotion of FDI since 1987; the acute infrastructure inadequacies that discourage foreign investors to invest in the Philippines have since been gradually addressed at the onset of the 1990s by the Filipino government in an effort to attract more FDI inflow (Nomura Research Institute et al, 1995).

Thus, at the beginning of the 1990s, the South-east Asian countries grew out of the troubled decade of the 1980s characterised by debt crisis and the collapse of commodity market. The thrust of their economic planning shifted from import-substitution to export-oriented strategies, which was evident from their strong export growth figures and the steady expansion of manufactured exports (Villegas, 1990). The most significant development after the 1980s was conceivably the trend of increasing FDI, which has continued to be one of the “engines of growth” in this region during most of the 1990s¹³.

¹² For example, the growth of exports in South-east Asia, except in Indonesia, has substantially outpaced that of GDP in the mid 1980s (Arya, 1990).

¹³ The onset of the infamous East Asia financial crisis in late 1997 has seriously retarded the strong economic performances of South-east Asia, in particular Thailand and Indonesia. The inflow of FDI has sharply declined as a result. The present study, however, will not look into the causes and impact of this latest financial crisis in detail for the following reasons. First of all, the exact causes of this crisis have been keenly debated and no definite conclusion has been agreed. Secondly, the impact of this crisis will continue to be felt several years from now, which make a thorough assessment impossible at this stage. Thirdly, and most crucially, the role of the BWIs in assisting the governments to deal with the crisis of this nature is different from the one the present study focused, namely, the role of promoting development. As

6.1.2 The role of the BWIs

This section will draw from the existing literature and research to ascertain whether the BWIs programmes have been effective in producing an *outcome* and an *impact* in Southeast Asia. The BWIs' involvement before the 1980s in the process of South-east Asia's economic development included technical assistance regarding economic policy reforms and project lending from the World Bank¹⁴. For example, in post-colonial Malaysia, the government based its import-substitution industrialisation policy on the recommendations of a World Bank mission in 1954 (Sundaram, 1987). Thailand had received more than US\$ 180m in loans from the World Bank by the mid 1960s, which accounted for half of the funding from overseas loans for the first development plan (Hewison, 1987). The Private Development Corporation of the Philippines, whose purpose was to promote and lend to the private sector, was set up in 1963 with the encouragement and assistance from the World Bank (Castro et al, 1975), and an emergency mission from the IMF was called upon to arrive in January 1970, when the Philippines was unable to meet its payment obligations as its balance of payments had been deteriorating, and as foreign creditors insisted that the debt restructure was conditional upon government acceptance of an IMF stabilisation package (Fayasuriya, 1987).

It was not until the South-east Asian countries undertook the process of structural adjustment in the early 1980s that the BWIs appeared to have more influence over this region in terms of providing policy advice with their lending activities. The prevailing difficult balance of payments situation and crisis in state revenues resulting largely from falling world commodity prices, coupled with the accumulation of large foreign debt,

a result, discussion of this latest financial crisis will only be conducted to the extent that is relevant to the present study.

¹⁴ Note that Indonesia briefly withdrew from the IBRD in 1965 and rejoined again in 1967.

tilted the political influence and power toward the international financial institutions, in particular, the BWIs (Robinson, 1987). Thailand, the Philippines, Malaysia, and, to a lesser extent, Indonesia, have all been subjected to acute intervention by the IMF and the World Bank. The Philippines had one SAL from the World Bank, which was coordinated with an IMF EFF, extended in 1979 (Fayasuriya, 1987) and has had a series of stand-by arrangements covering almost the entire 1980s. It also implemented the IMF-supported adjustment programmes in the 1980s (Hemming et al, 1990). Thailand, whose development policies have been closely associated with the BWIs since the early 1950s, has received three stand-by arrangements from the IMF and two SALs from the World Bank in the 1980s (Hewison, 1987). Malaysia has availed itself of credits under the buffer stock financing and Compensatory Financing Facilities of the IMF during the 1980s when experiencing the unstable world commodity market (Mohammed, 1990). In addition, the BWIs, by ways of affecting Malaysia's international credit and investment rating, was able to assert their influence in Malaysia in this regard, which can be attested from the various deflationary and deregulatory policies adopted by the government in the 1980s (Sundaram, 1987). Even in Indonesia where the BWIs were less able to assert their power in terms of lending activities, the policy suggestions contained in a 1981 World Bank report, which is produced in response to the Indonesian situation, have begun to be adopted in the 1980s despite the initial irritation of the Indonesian government toward this World Bank report (Robinson, 1987).

During this period, the BWIs have lent several loans for structural adjustment purposes: four SALs and several SECALs from the World Bank and one EFF from the IMF¹⁵. Both types of the loan¹⁶ contain high conditionality¹⁷. With the application of

¹⁵ The SAF and ESAF of the IMF were only set up in 1986-87 and were not yet available for the South-east Asian countries during this period. However, the EFF of the IMF was the main facility provided for longer-term adjustment purpose before the SAF and ESAF came into place.

conditionality and policy-based lending, the BWIs acquired much leverage over the borrowing governments in South-east Asia. Conditions and policy recommendations provided by the BWIs were incorporated to a large extent. For example, in the case of Thailand, in order to implement conditions under the two SALs from the World Bank, certain legislative action were undertaken. Legislation was submitted to Parliament for overhauling motor vehicle taxation as part of the tax policy reform, and bill that reformed operations of, and transferred selected business taxes to the Excise Department for administration was enacted (Sahasakul, 1992). For countries that did not apply for loans from the BWIs (eg Indonesia) or apply for loans with low conditionality requirement (eg Malaysia), the influence of the BWIs in inducing domestic policy change might be more difficult to ascertain than in countries where SAPs existed (eg Thailand). Nevertheless, through their technical advice and consultation in the process of negotiating loans, the BWIs definitely had the access to influence policymakers in these governments, and played a role in the process of South-east Asian's economic development¹⁸.

On the other hand, it is more uncertain as to whether the programmes of the BWIs have been effective in achieving the desirable result, ie an *impact* in these countries. Each country has its own perception of the BWIs and is in a different position

¹⁶ The term "loan" here refers to loans from the World Bank and arrangements and/or facilities from the IMF.

¹⁷ The SALs, compared to other project loans, have with it higher degree of conditionality, which is applied in the way the SALs are disbursed. The conditionality applied in the EFF is less intensive than that applied in the SAF/ESAF, but is more intensive than that applied in other facilities such as the Compensatory Financing Facility.

¹⁸ Admittedly, there is no consensus as to the role the BWIs played in the process of economic development in South-east Asia or how effective have these SAPs been at contributing to the growth in this region. For example, one study by the Overseas Development Institute in London on the effectiveness of the BWIs adjustment programmes on South-east Asia concludes that: "... conditionality played only a limited role in the adoption of [adjustment] policies" in SEA. (Marr, 1996, p. 7) Nevertheless, although conditionality did not play a main role in inducing policies, the role of the BWIs in influencing the shape and direction of economic policies through other techniques such as policy dialogue and the building of intellectual capabilities have been acknowledged in this study.

to deal with the BWIs. In the case of Thailand, most of the conditionalities¹⁹ attached to the two SALs signed at 1982 and 1983 had already been taken up on the government's own initiatives (Sahasakul, 1992). Nevertheless, the IMF and World Bank conditionality and austerity programmes seemed unable to tackle the crisis Thailand faced in the 1980s and, hence, the effectiveness of these programmes were subjected to serious doubt among business leaders as well as political and military leaders. Furthermore, it was believed that cheaper loans with less stringent conditions could be raised elsewhere. As a result, a third SAL from the World Bank was dropped from the government's plan of external borrowing in 1986 (Hewison, 1987). In fact, one study concluded that: "Those elements of the SAL which were conditional were generally the least successfully implemented ..." (Sahasakul et al, 1991, cited in: Marr, 1996, p. 38). The Philippines, possibly the most hard-hit by the debt crisis among the four, had only the BWIs to turn to for financial assistance and realised that its debt restructuring was most often contingent upon its acceptance of either the IMF's stabilisation programmes or the Bank's structural adjustment programmes²⁰. The contention between the Philippine government and the BWIs over a variety of policies, such as trade liberalisation measures, existed throughout the 1980s (Fayasuriya, 1987). What is more controversial is that, after a series of IMF-supported programmes and stand-by arrangements covering the 1980s, the evidence of balanced and sustained growth was not as clear in the Philippines as in the case of, for example, Thailand (Hemming et al, 1990)²¹. In the case of Indonesia, the group of technocrats who were responsible for designing Indonesia's first phase of adjustment

¹⁹ Conditionality in the context of the World Bank is most relevant in the case of SALs and SECALs. For more discussion on conditionality, see Chapter 3.4.

²⁰ The circumstance where a debt rescheduling is conditioned upon the debtor country reaching a loan agreement with either of the BWIs might amount to "cross-conditionality" — an "informal indirect financial cross-conditionality" as one author named it (Kremmydas, 1989). For more discussion on the different types of conditionality, see Chapter 3.4.

programmes between 1983-85 were supported, technically and financially, by the World Bank and the IMF (Guillouet, 1990). However, the earliest adjustment programme in 1983 was not initially financed by the World Bank and a substantial part of Indonesia's subsequent adjustment effort was not financed in the form of SALs/SECALs from the World Bank, albeit elements included in its adjustment programmes were similar to those in many SALs/SECALs (Jayarajah and Branson, 1995). As for Malaysia, the role of the BWIs was somehow limited in terms of their lending facilities. However, in terms of their policy influence, the BWIs still maintain a certain degree of leverage over Malaysia, as mentioned earlier, for the BWIs can strongly affect the international credit and investment rating (Sundaram, 1987)²².

All these four South-east Asian countries certainly have achieved various degree of economic growth²³ throughout the 1980s and the first half of the 1990s. However, from the preceding discussion, it is difficult to ascertain whether the BWIs and their programmes has been the main driving force behind this success. Admittedly, this brief case study has not presented direct empirical data from the existing research demonstrating the arguments suggested in Chapter 3 relating to the effectiveness of the SAPs²⁴, in particular in the context of the correlation between governance structure and effectiveness. Nonetheless, the preceding paragraphs managed, drawing from the existing literature, to provide some indirect evidence on the effectiveness of the SAPs in South-east Asia in producing the *outcome* (eg in the case of Thailand) but not the *impact*

²¹ In the research carried by the Overseas Development Institute, the failure of the BWIs programmes in the Philippines was attributed more to the domestic factors, in particular political ones. (Marr, 1996, pp. 39-42).

²² See Chapter 3.2 for more discussion on how the BWIs assert their influence over developing countries through the application of various instruments used mainly, but not exclusively, in their adjustment lending.

²³ The traditional yardsticks such as GDP and GNP measure the term "growth" here.

²⁴ There are even studies suggesting that the SAPs of the BWIs did not have impact at all in terms of influencing the South-east Asian governments' economic and developmental policies in their process of economic development (eg Marr, 1996).

(eg in the case of the Philippines). Another implication brought out by the case study on South-east Asia was the need for the BWIs to re-examine their traditional role as providing funding for “economic” development purposes in the 1990s, as the following discussion will show.

One of the most important policy recommendations from the SAPs of the BWIs has been the promotion of FDI in this region through various favourable measures. Before the 1997–98 financial turmoil hit the region, all these four South-east Asian countries have been able to attract FDI from developed countries as well as the Asian NICs. As a result, they have been less and less inclined to resort to the BWIs for financial assistance, to which a string of conditions are always attached, in particular in programme and policy-based lending²⁵. It seems tempting to conclude that the BWIs could be pushed into a more marginal role in this region in the 21st century. However, when the financial crisis broke out in the region in late 1997, the BWIs have assumed a centre role again in providing the financial sources urgently needed. Nevertheless, the nature of this role played by the BWIs in 1997–98 was different from that in the 1980s. The presence of the BWIs in this region throughout the 1980s has largely been to provide finance and policy advice for development purposes; while their recent role in some of the South-east Asian countries is to quickly provide financial resources to respond to an emergency situation. In addition, the characteristics of conditionality and policy advice prescribed in the recent “rescue” package from the IMF are different those applied by the BWIs in the 1980s²⁶.

²⁵ The experience of Thailand, as mentioned in the previous paragraph, in which a third SAL from the IBRD was dropped by the Thai government is a good example.

²⁶ The causes of the recent Asian crisis were a combination of weak financial system, huge capital flows, and unwise private-sector borrowing. It had little to do with macroeconomic policy failure (Financial Times, 7 January 1998). As a result, the policy advice prescribed by the emergency loans from the BWIs, in particular from the IMF, focuses more on the reform of domestic financial sector. This is different from the macroeconomic policy advice usually prescribed by structural adjustment lending, which was applied in the 1980s in South-east Asia.

The BWIs have made their presence in South-east Asia since the 1950s and played an important role in the process of economic development in this region. Their influence reached its peak in the 1980s when they had the greatest leverage over the governments through gaining access to their economic policy-making process²⁷. Before the financial crisis broke out, the services provided by the BWIs in terms of promoting development have been in less demand in these South-east Asian countries. This, in turn, has rendered the influence of the BWIs over these countries less and less significant. The recent Asian crisis might have helped the BWIs to regain their influence in terms of gaining access to the policy-makers through their lending activities. However, the role as a “fire fighter” is only a small part of the functions of the BWIs envisaged by their founders back in the 1940s²⁸. In addition, the role has brought about new tensions between the BWIs and the borrowing governments since the terms and conditions under such emergency assistance are often being criticised as harsh²⁹. Furthermore, the effectiveness of these loans in tackling the crisis remains to be seen. How, then, can the BWIs find a new role in the region which is less controversial? The new role the Bank assumes after the 1990s in assisting the implementation of the MEAs might provide some clues.

When South-east Asian countries began to face serious domestic environmental problems and to contribute to regional and global environmental degradation, sustainable development suddenly ceased to be mere a slogan and became a practical policy alternative for South-east Asian countries. The acute environmental problems require

²⁷ In the process of negotiating and designing a SAP, the BWI is able to generate profound changes in development policy and economic structure of the borrowing country (Reed, 1992).

²⁸ It can be argued that this role of the BWIs, in particular of the IMF, has only had its origin after the similar crisis broke out in Mexico in 1992-93. In fact, an Emergency Financing Mechanism was only adopted in September 1995 by the IMF Board of Executive Directors, which established an accelerated procedure to enable the Fund to respond swiftly in support of a member facing an external financial crisis and seeking financial assistance from the IMF (IMF, 20 August 1997).

²⁹ See, for example, Financial Times, 15 December 1997.

technical and financial resources to tackle. These resources might now become scarce when the financial crisis hit the region. Under this circumstance, the innovative mechanisms of the World Bank might be able to offer assistance. This might also provide an opportunity for the BWIs to re-examine their role in the region. The next section will first review the environmental impact, in particular on climate change, of South-east Asia's economic development during the 1980s when major structural adjustment took place.

6.2 South-east Asia and climate change

6.2.1 *The environmental impact of "economic" development on climate change*

As has been identified in Chapter Five, the traditional, neo-classical development path undertaken by industrialised countries and advocated by the BWIs significantly contributed to the greenhouse problems. Since the development strategies favoured by the BWIs and adopted by the South-east Asian governments mirrored those of the industrialised countries, the problem of climate change poses potential threats to the region, as well as to the world. In the following discussion, the environmental impact of South-east Asia's economic development will be laid out with specific reference to the problems contributing to climate change, such as pattern of energy use and deforestation.

Due to its colonial history, South-east Asia's economy took off on the basis of its abundance natural resources in the late nineteenth century. The development strategies through the early years of independence rested ultimately on resource-based production for export and for domestically consumed food-stuffs and raw materials. (Brookfield, 1993) Though the shares of agriculture and mining in GDP show a steady decline after the 1980s, production based on natural resources has not diminished as significantly as in the Asian NICs. Despite the rapid growth in the share of manufacturing in GDP and in

export, employment in the manufacturing sector has not risen proportionately. As a result, measures based on under-priced resource exports and on resource-based manufactures for poverty eradication purposes have continued after the 1980s. (Brookfield, 1993) In addition, a large part of industrialisation and the provision of infrastructure are still financed through the massive exploitation of natural resources in the early 1990s. (Brookfield, 1993) For countries like Indonesia and Malaysia where natural resources abound, export-earnings from petroleum and timber constitute a large share of their foreign exchange earnings. (Seda, 1993) As a whole, natural resources, in particular petroleum and timber, will continue to play an important role in the economic development process in the region of South-east Asia. This can already be observed after the financial crisis since countries suffering economic difficulties have to earn foreign exchange in a short period of time and export of natural resources seem to be a quick-fix. For example, a draft budget proposal proposed by the Indonesia government in January 1998 depended heavily on oil and gas revenues to correct the country's balance of payments deficits. (Financial Times, 24 January 1998)

The resource-based economies in South-east Asia inevitably resulted in some environmental problems. For example, deforestation, resulting from various reasons³⁰, is not only itself a fundamental problem of environmental degradation in the region, (Seda, 1993) but also reduces the sink functions in absorbing the GHGs. Take Malaysia and Thailand for examples. It has been estimated that deforestation has resulted in a decline of Malaysia's forested area from three-quarters of the nation in 1958 to well under half of the nation in 1985; and in a decline in Thailand's forested area from 53% of the nation in 1961 to 29% in 1985 (Hirsch, 1987). Another environmental problem associated with deforestation is the GHGs emitted through the burning of the forests. It has been

estimated that land use changes, especially deforestation account for more than 70% of the emissions in South-east Asia³¹ (Sharma, 1994). In addition, rapid industrialisation and urbanisation, both of which can lead to significant GHGs emission, represent yet another sources of environmental degradation³² (Jones, 1993).

The South-east Asian governments undertook a series of structural adjustment reforms in the 1980s to control the external imbalance and associated foreign debt problems. Some reforms were carried out through the governments' own initiatives³³; others were subject to the SAPs of the BWIs following their structural-type loans³⁴. The various structural adjustment policies adopted by the South-east Asian governments all aimed at the improvement of their macroeconomic conditions. Since the linkage between macroeconomic policies and the environment did not draw immense attention until later 1980s and early 1990s, it is fair to point out that environmental constraints were not reasonably taken into consideration in the design and implementation of these structural adjustment policies. For example, externalities of environmental costs³⁵, one of the causes for environmental degradation, were recognised by neither the governments nor the BWIs and, hence, were not incorporated and rectified in the process of structural adjustment. Meanwhile, excessive and urgent demand for foreign exchange for balance of payments purposes exacerbated environmental degradation because export earnings

³⁰ For example, inadequate forest management, slash and burn practices, forest clearance in order to plant cash crop and so on. For more detail account, see, for example, Potter, 1993; Wirawan, 1993.

³¹ The clearing of forests for agriculture has been a major cause of the recent forest fire in Indonesia in 1997. The fire has caused disastrous regional environmental problems including smog and heavy air pollution throughout the region.

³² Environmental degradation associated with industrialisation and urbanisation include, for example, air and water pollution in the process of industrial production, and health problems resulting from inadequate sanitation and other basic health services and air pollution in the rapidly expanding urban area, in particular in those mega-cities such as Bangkok. In addition to these domestic environmental problems, transboundary air pollution, such as the resulting acid rain, is another example.

³³ For example, Malaysia's third phase of development, 1986-90, was one on adjustment and liberalisation, which was incorporated in its National Development Policy (Salleh et al, 1993).

³⁴ For example, there were two SALs from the World Bank to Thailand in 1982 and 1983 (Sahasakul, 1992).

from primary products and natural resources seemed to be an easy and attractive option. For example, timber extraction is still largely regarded as an integral component of economic growth plans in both Indonesia and Malaysia in the early 1990s (Seda, 1993). As for the environmental impact of the BWIs-supported SAPs, several studies have been conducted in the cases of Thailand and the Philippines (eg Cruz and Repetto, 1992; Panayotou and Sussangkarn, 1991). Although none of the studies focus specifically on the environmental impact of climate change, most of them criticised the inadequacy of the designs of these programmes for their lack of environmental considerations.

Along with deforestation, the increasing energy demand and the associated problems of climate change will be another issue of concern in the ever-growing complicated relationship between economic growth and environmental protection in South-east Asia. The absolute energy demand will increase significantly in South-east Asia, given that this region is expecting the highest economic growth in the 21st century³⁶ (Clark, 1993). A major environmental impact of this expanding energy demand will be the emissions of GHGs with effects in terms of global warming and acid rain, because Asia³⁷ is 90% dependent on fossil fuels for primary energy (Baker, 1994). Furthermore, according to one estimate, South-east Asia has been a major source of methane, another GHGs emissions since the late 1980s (Brookfield, 1993). As a result of this energy demand, as well as the state of deforestation, GHGs emission from South-east Asia is likely to become globally significant in the very near future. The actual impact of climate change on the region of South-east Asia has not been ascertained due

³⁵ Externality, also referred to as “market failure”, refers to the imperfection in a price system that prevents the cost of environmental goods and services to be fully incorporated.

³⁶ The reference made here refers to the Asia-Pacific region as a whole, including South-east Asia. This reference should only be used in an illustrative manner since the ratio of the increase of energy demand between the Asian NICs and South-east Asia countries are unclear and the figure derived is the average of these two groups. In addition, the figure might need further adjustment considering the impact of the recent financial crisis would have had on the economic performance of the East and South-east Asian countries.

partly to the unclear geographical definition of “South-east Asia” in various reports³⁸ (Henderson-Sellers, 1993). However, the variations associated with climate change, such as sea level rise, rain fall variability, and the warming of temperature, will have significant impact on South-east Asia. For example, rain fall variability and the rise of temperature will have immense impact on agriculture; and sea level rise will become a big threat to the archipelago states, such as the Philippines and Indonesia, in the region. Thus, the governments of at least some South-east Asian countries are conscious of global climatic change and its likely implications on human activities, and are making efforts to improve understanding of the nature and mechanisms of regional climate and policy options (Sani, 1993).

To conclude briefly, for the previous four decades, South-east Asian countries have paid insufficient attention to the impact economic development can have on the environment. Natural resources, as the major source of export earnings, were subjected to unsustainable management, particularly at the early stage of their economic development. During the adjustment decade of the 1980s, understanding on the linkage of macroeconomic policies and the environment was too insufficient to design environmentally benign adjustment policies. Moreover, the development strategies and economic policies pursued by the governments in South-east Asia and supported by the BWIs have contributed to the problem of climate change and rendered the implementation of FCCC difficult. Consequently, national and regional, as well as global, environmental problems associated with climate change emerged and required more and more resources to remedy. The recent Asian financial crisis has put a constraint in these South-east Asian governments to come up with the adequate resources. As a

³⁷ Here, again, “Asia” refers to the Asia-Pacific region, which includes South-east Asia as well. The same reservation as the previous footnote has pointed out should be noted.

result, how to achieve a balance between recovering economic growth and maintaining environmental standard will pose the greatest challenge to the governments in South-east Asia. At this junction, the World Bank should be able to play its new role of assisting the implementation of the FCCC by offering its innovative mechanisms to aid these South-east Asian countries in implementing the FCCC. The next sub-section will first examine the relationship between the South-east Asian countries and the FCCC.

6.2.2 *South-east Asia and the FCCC*

The potential impact of the adverse effects of climate change on the Asian countries seems disproportionate to their historical contribution to the problems. For example, large areas of Asia dependent on monsoon rains may be especially vulnerable, because of the effects of greater variability in the timing, size and distribution of the rains brought by the climatic change. (Killick, 1992) Other impact includes: significant coastal tidal wave due to sea-level rise, increasing monsoon season flooding, reductions in agriculture and fishery production, and large-scale displacements of population³⁹ (Qureshi and Hobbie, 1994, cited in Topping et al, 1996).

The historical emissions of the GHGs might be low in South-east Asia. They, however, are catching up quickly as the process of industrialisation in the region accelerates. According the International Energy Agency, the carbon dioxide (CO₂) emissions in Asia was 3.7% in 1973, but reached 9.9% in 1995, ie it nearly tripled in two decades⁴⁰. The CO₂ emissions per unit of GDP in East Asia, including South-east Asia, are three times the level in Latin America. If past trends continue, East Asia will account

³⁸ For example, the IPCC Scientific Report identified five regions, ie Central North America, Southern Asia, Sahel, Southern Europe and Australia, for which model-based consensus climatic changes for 2030 were constructed.

³⁹ For the individual country report on climate change and global warming in South-east Asia, see: Garcia and Peralta, 1991 (the Philippines); Sagetong, P, 1991 (Thailand); and Sasmojo et al, 1991 (Indonesia).

for more than half of the world's incremental CO₂ and sulphur dioxide emissions, except to the extent that cleaner technologies are used (World Bank, 1993b, p. 41). The most important source of anthropogenic emissions of GHGs in the Pacific Rim is the energy sector, the end use of which is predominantly by the industrial sector (44%) (Uzawa, 1991). The energy demand of an economy is usually a function of its GDP, its industrial structure and the energy intensities of its sectors. As a result, a higher growth rate of GDP, as is in the case of South-east Asia, is associated with a higher growth rate of energy demand. CO₂ emissions are closely related to total energy consumption and fuel mix. Korea and Thailand, for example, had the fastest growth rates of CO₂ emissions of 7% and 6%, respectively (Han and Chatterjee, 1997).

In addition to the CO₂ emissions, irrigated rice fields, a common scenery in rice-producing countries in South-east Asia, are estimated to emit into the atmosphere methane that is responsible for approximately 20% of the methane emissions in the Pacific Rim. Slash-and-burn, a wide-spread practice in South-east Asia particularly related to the increase in unemployment in the sugarcane and other industries, has double implications for the phenomenon of global warming — the release of CO₂ by the burning of forests and the emission of CO₂ and methane through the processes of decay and decomposition (Uzawa, 1991). Deforestation activities for commercial purposes, particularly by large multinational corporations, have been on a gigantic scale since the 1970s. During the process of burning the forest, not only CO₂ will be emitted, disastrous forest fire causes regional air pollution as well, as has been witnessed in the Indonesia fire in late 1997 and early 1998. Deforestation reduces the sink function of forests in absorbing CO₂ emission as well.

The recent economic turmoil in South-east and East Asia that began in the

⁴⁰ However, "Asia," as defined by the IEA, includes countries in North and South Asia, but excludes

autumn of 1997 might retard the economic growth and result in a lower GDP growth rate in the region. Considering the correlation between energy demand and the growth rate of GDP, this might suggest that the energy demands, hence the emissions of GHGs, will decrease during the next couple of years in this region⁴¹. However, without proper policy safeguards, some of the resource-rich South-east Asian countries might resort to exploiting their natural capital stock in the hope of earning more foreign exchange. Deforestation due to commercial logging and the practice of slash-and-burn might also be likely to increase in the face of high unemployment and financial difficulties. Therefore, it is very difficult to predict how this financial crisis in South-east Asia is going to affect the climate change regime⁴².

Compared with other less developing countries, however, South-east Asia still stands out as the higher level of industrialisation and the consequent energy demand have rendered the region to produce the highest level of GHGs emissions among developing world⁴³. Applying the principle of common but differentiated responsibility, the FCCC distinguishes its Parties and imposes different treaty obligations correspondingly. In the Kyoto Protocol, differentiation is made between Annex I Parties as well. For instance, the targets privately agreed are different between the EU, the US, and Japan. Economies in transition are given different treatment in the Annex I Parties (for example, Kyoto Protocol, Article 3.5). In view of this trend, differentiation is very likely to be made

China. Therefore, this figure does not exclusively represent the change of CO emission in South-east Asia.

⁴¹ However, in a preliminary study on the impact on industrial growth and environmental performances in Indonesia after its financial crisis, it is observed that "since the start of the crisis pollution intensity for organic waste in industrial effluents has increased by 15%" (Afsah, July 1998). Although the study only examines water pollution, the reasons for these poor environmental performances, ie the lower regulatory inspection and enforcement and higher pollution control costs, might cause other environmental problems such as air pollution and climate change.

⁴² Most of the literature produced so far concentrate on the financial and economic aspect of this Asia crisis. Few have looked at the social impact of the adjustment programmes designed either by the governments or from the IMF. See, for example, Khor, 1998. Even fewer have yet to look at the environmental impact of the financial crisis and the rescue measures.

⁴³ For example, the CO₂ emissions per unit of GDP in East Asia, including South-east Asia, are three times the level in Latin America.

among non-Annex I Parties, ie developing country Parties, when the next round of negotiation begins. If this is the case, more advanced developing countries with higher emissions level, such as East and South-east Asian countries, are probably the first group of non-Annex I Parties to be required to undertake more substantive commitments under any future Protocol⁴⁴.

The development path after the 1970s in South-east Asian countries has followed the traditional model of “economic” development advocated by the BWIs. As has been discussed previously, SAPs from the BWIs have, to a large extent, encouraged this model of development during the 1980s. As this section has demonstrated, environmental impact in general of this traditional model of “economic” development has been felt in the region of South-east Asia in terms of domestic, regional, and global environmental problems. On the one hand, the circumstance might provide a good opportunity for the World Bank to employ its innovative mechanisms to help countries of South-east Asia to deal with potential threat imposed by climate change. On the other hand, this unintended environmental impact of a development path promoted by the BWIs has wider implications for the BWIs. As Chapter 5 pointed out, instead of challenging the basic ideology and economic theories behind the design of the SAP, this thesis suggests a more modest reform for the BWIs to consider an introduction of “SAP with a climate safety net”. The case study on South-east Asia, however, clearly demonstrated the inadequacy of the underpinnings of the traditional model of “economic” development in failing to take the environmental constraints into account. This, as a result, contradicted with the commitments publicly made by senior

⁴⁴ For example, during the Kyoto Protocol negotiation, a New Zealand proposal called for “progressive engagement” according to relative levels of development when discussing whether developing countries should promise to undertake binding emissions limitation commitments. The central thrust of the New Zealand proposal is the so-called “double conditionality” — Annex I Parties needed early agreement by non-Annex I Parties on future commitments, but non-Annex I Parties would not be held to commitments if

management of the BWIs to the goal of sustainable development. “SAP with a climate safety net” might help to correct some of the environmental impact relating to climate change brought about by the traditional model of development promoted by the BWIs. It is, however, unable to address the fundamental causes of and solutions to climate change and environmental degradation in general brought out by this traditional model of development as long as the donors and the management of the BWIs stop short of re-evaluating the underpinnings of “development” they seek to promote in the developing countries. Admittedly, a reform on such a grand scale is bound to be difficult to implement in the short run. Nevertheless, from the recent Letter of Intent submitted by the Indonesian government to the IMF for a stand-by arrangement in 1998 in which environmental factors have been taken into account, encouraging sigh has emerged toward this wider and more fundamental reform in the BWIs.

In the meantime, South-east Asian governments are facing difficulties in dealing with the problems of climate change and in implementing the FCCC in the face of declining domestic resources after the recent financial crisis. The World Bank with its innovative mechanisms designed specifically for the purpose of controlling climate change can not be placed in a better position now to assist their South-east Asian members to implement the FCCC and to adopt a more sustainable development path.

6.3 Can the innovative mechanisms help?

How can the BWIs assist their South-east Asian members to implement the FCCC in the face of financial crisis? As these South-east Asian countries become

Annex I Parties did not fulfil their Kyoto commitments. This proposal was objected by most of the developing countries and failed in the end.

“better-off” they are no longer eligible to draw from the ESAF of the IMF⁴⁵. In fiscal year 1998 amid the financial crisis, two SALs were concluded: one Economic Recovery and Social Sector Loan to Malaysia and one Finance Companies Restructuring Loan to Thailand (World Bank, 1998a). These two SALs were designed with specific purposes in the face of dire financial situation and did not deal with structural adjustment process that involves comprehensive macroeconomic-policy reforms. It seems, thus, that the “SAPs with a climate safety net”, as proposed in the preceding chapter, might have difficulties to apply in these two SALs. Nevertheless, any future SALs/SECALs from the World Bank, if involving a comprehensive structural adjustment process, can still be designed with a “climate safety net” to assist the implementation of the FCCC in this region. At the moment, on the other hand, the innovative mechanisms of the World Bank seem able to provide more readily available financial resources to these South-east Asian countries to tackle the threat of climate change⁴⁶.

The discussion in Chapter 5 on the evaluation of these innovative mechanisms illustrates that these mechanisms of the World Bank have the prospect of offering developing countries more financial resources to implement the FCCC under conditions that are designed in a decision-making process with more participation from developing countries. In the case of South-east Asia, can these innovative mechanisms help in the face of a deteriorating environment, natural as well as economic?

Environmental problems such as global warming have international benefits as well as local ones. However, from the perspective of national and local costs and benefits, these problems may not necessarily be of high priority, in particular in a

⁴⁵ Only members listed in the Annex to the decisions regarding SAF/ESAF are eligible to draw from these two facilities. All four South-east Asian countries discussed in this chapter are not on the lists. However, other South-east Asian countries such as Cambodia, Lao, Myanmar, and Vietnam are still eligible to draw from the ESAF as of 1996.

growth-oriented region like South-east Asia (Hammer and Shetty, 1995)⁴⁷. After the financial crisis broke out in 1997, it is not difficult to envisage the lack of resources to attend to environmental problems. In addition, as South-east Asian countries do not have substantive commitments to reduce GHGs emissions under the Kyoto Protocol yet, it is understandable that the control of GHGs emissions might be low on the agenda of the governments in South-east Asia. However, as the environment might be further threatened after the Indonesia forest fire and the financial crisis⁴⁸, this lack of determination and resources in the South-east Asian governments could seriously affect the prospect of tackling the threat of climate change in this region.

In response to the financial crisis, the IMF has already negotiated stand-by arrangements with Thailand and Indonesia. It is an encouraging sign that in the Annex to the Letter of Intent from the Indonesia government to the IMF, dated 29 July 1998, "environment" is included in the matrix of structural policy commitments⁴⁹. Nevertheless, there is no indication that resources will be reserved to deal with environmental problems. Therefore, the innovative mechanisms of the Bank might be a source of external financing for South-east Asian countries to tackle the threat of climate change and other environmental problems.

The financial resources available under these innovative mechanisms might be insignificant compared to those available under other regular loans from the BWIs. The latest replenishment of the GEF, agreed on March 1998, has pledged US\$ 2.75bn covering fiscal year 1998-2001. The proposed PCF under the Bank GCI has its initial

⁴⁶ As of October 1998, there are six GEF projects in the climate change portfolio operating in these South-east Asian countries: three in Indonesia, one in the Philippines and two in Thailand. Note that all six of them are associated with World Bank lending.

⁴⁷ For example, in a recent World Bank report on the environmental issues and priorities for East and South-east Asia, problems relating to global warming and climate change are not even mentioned in the report (World Bank, 1997b).

⁴⁸ See, for example, Afsah, July 1998 and the Chapter 6.2.2 for further discussion.

pledge of US\$ 100-120m. As for the Bank AIJ programme, it is estimated that amount available from a single donor may be in the range of US\$ 2-5m for each project. On the other hand, the IBRD alone handed out US\$ 11bn of its SAL/SECALs during fiscal year 1998. The amount of money available for Thailand and Indonesia under the stand-by arrangements recently agreed with the IMF is about, respectively, US\$ 3.9bn and US\$ 6bn.

Regardless of the comparatively small amount of money these innovative mechanisms are able to provide, they still represent a source of finance exclusively for environmental purposes. In addition, it is expected that projects funded under these mechanisms will be able to leverage other external finance⁴⁹. Moreover, if formal link between these mechanisms with the FCCC and Kyoto Protocol is to be established, and emissions reduction from projects funded under these Bank's mechanisms can be credited under the Kyoto Protocol, these mechanisms will then be able to attract more donors, state or private parties, and to leverage more financial resources. The financial resources available under these innovative mechanisms might, as a result, increase. South-east Asian countries have already received several GEF grants since its pilot phase came into operation.

There are six GEF projects in the climate change portfolio in South-east Asia as of October 1998. All the six GEF projects are associated with World Bank lending. In addition, in response to the Indonesia forest fire and the resulting haze problem in South-east Asia, a medium-sized GEF project, "Indonesia: emergency response measures to combat fires in Indonesia and to prevent regional haze in South-east Asia", has been granted in June to July 1998. As for the JI-related mechanisms, no Bank AIJ projects are

⁴⁹ For example, the Indonesian government indicated that it will accelerate programmes for converting to cleaner fuels by the end of 1999.

undertaken in South-east Asia at present. As for the PCF, South-east Asian countries did not participate in the first Consultative Group Meeting for the PCF Potential Host Countries, which was held in March 1998 in Slovak Republic⁵¹. South-east Asian countries should tap into the resources available under these mechanisms as they have few alternative source of finance for environmental purposes left in the face of economic difficulties. The BWIs, in addition to providing assistance for their financial difficulties, should also inform these South-east Asian countries the opportunities available under the innovative mechanisms of the World Bank in helping to tackle environmental problems such as climate change in the region.

⁵⁰ For example, the independent evaluation report on the operation of the GEF I concluded that: "GEF grants have leveraged additional funding for global environmental benefits from both Implementing Agencies and other funding sources." (GEF, March 1998, p. xi.)

⁵¹ Briefings of this and other Consultative Meetings can be found at: <http://ww-esd.worldbank.org/cc>.

CHAPTER 7: CONCLUSION

When private capital began pouring into developing countries in the 1990s, the BWIs found themselves playing diminishing roles as major providers of financial resources for developmental purposes. As more developing countries begin turning to other external financial sources, the influence of the BWIs over their developing country members might gradually decline as the legal and quasi-legal instruments used for leveraging influence, such as structural adjustment lending, programme and policy-based lending and conditionality, would be applied less frequently. In the meantime, developing countries continue to assert that their domestic resources have been stretched to the limit to implement various MEAs that have proliferated in the past decade.

After publicly endorsing the concept of sustainable development at the 1992 UNCED, the BWIs, in particular the World Bank have been offering themselves a new role in assisting the implementation of MEAs in developing countries. The most noticeable trend towards this move is the introduction of innovative mechanisms by the World Bank for the specific purpose of providing resources to implement the MEAs, the FCCC being one of the most important.

This thesis set out to examine whether the experiences of the BWIs in promoting “economic” development, a traditional development model, in developing countries might provide valuable insights as to how can they promote “sustainable” development through the implementation of the FCCC in developing countries. To this end, this thesis has examined the following. Firstly, the governance structure of the BWIs and its implications on the relationship with the developing countries. Secondly, the legal and quasi-legal instruments employed by the BWIs in their existing SAPs operations to

influence developing countries and the effectiveness of these instruments. Thirdly, what lessons can be learned in the operations of the SAPs to understand what makes these legal and quasi-legal instruments effective or ineffective. And, finally, whether these lessons can be applied in the Bank's innovative mechanisms to enable the World Bank to play a more effective new role in assisting the implementation of the FCCC. The main conclusions follow.

As Chapter 2 pointed out, the relationship between the BWIs and the developing countries has been affected by a governance structure that is perceived as asymmetrical by the developing countries. Developing countries have, since 1972, campaigned for the reform of a decision-making process by arguing that the process was dominated by developed countries and that it failed to reflect the needs or importance of the developing countries. However, little has been achieved. By virtue of their more frequent use of the BWIs' resources, developing countries were disproportionately subject to decisions relating to the BWIs' lending operations and more specific obligations arising from loan agreements or similar documents. The unbalanced decision-making process might deepen the negative feeling that developing countries have toward the BWIs in the sense that they are prevented from participating more fully in the decision-making process, and they have to bear the costs and consequences of the resulting decisions. As a result, developing countries might feel that they have been treated asymmetrically in the BWIs' decision-making process and their wider operations: the governance structure of the BWIs has thus affected the relationship between the institutions and the developing countries.

Chapter 3 examined the structural adjustment operations of the BWIs. All the relevant instruments used in structural adjustment lending from the BWIs, such as Letter

of Development Policy and Policy Framework Papers enable the BWIs to have immense leverage over the borrowing developing governments. Failure to comply with conditions prescribed in these instruments can trigger legal and/or practical consequences such as suspension and/or cancellation of loans or declining external financing from other sources. Programme and policy-based lending and the application of conditionality are arguably the most powerful legal and quasi-legal instruments employed by the BWIs to gain such leverage in influencing the developing countries. In terms of the effectiveness of these legal and quasi-legal instruments in inducing changes of domestic laws and policies, ie in producing an *outcome*, empirical evidence is rather indirect and patchy from the research papers produced by the BWIs and other institutions. The thesis nevertheless suggested a certain degree of the effectiveness in producing an *outcome* by analysing the issue from legal and political perspectives in the context of the leverage the BWIs may have over developing countries through the application of these legal and quasi-legal instruments. In terms of the effectiveness of the SAPs in achieving the desirable result, ie in producing an *impact*, the empirical research from the BWIs and other institutions is inconclusive as to whether the SAPs have been able to improve the overall economic state in the borrowing countries as envisaged by the BWIs. However, there were cases where the full implementation of conditions and policy recommendations of the SAPs have produced the intended results, and most of the relevant research suggests that “borrower ownership” is one of the keys for successful implementation. The thesis proceeded to examine what could have affected the intensity of ownership. Again, direct empirical evidence was elusive in the research conducted by either the BWIs or other institutions. Nevertheless, by examining the legal aspect of ownership in the context of “fairness” theory articulated by Franck, this thesis was able

to suggest that the asymmetric governance structure, perceived by the developing countries in the BWIs, has affected the perception of fairness that developing countries hold toward the BWIs. This has undermined the willingness of developing countries to implement rules prescribed by the BWIs. Moreover, from some references to existing literature and the analysis inferred by this thesis, it was revealed that the governance structure of the BWIs and its implications on the relationship between the BWIs and the developing countries might be one element that weakens the intensity of borrower ownership. As a result, the chapter was able to have a rudimentary conclusion that the governance structure of the BWIs might be one element that affected the effectiveness of these legal and quasi-legal instruments in producing an *impact*.

On the basis of these arguments and analysis, with various efficacy according to the availability of direct or indirect empirical evidence, proposed in Chapter 3, this thesis suggested that lessons learned from the experiences of the BWIs' SA operations are that the legal and quasi-legal instruments employed by the BWIs have been more effective in producing an *outcome* than producing an *impact*, and one of the key elements could be that the BWIs' governance structure was perceived as asymmetrical by developing countries and therefore affected the relationship between the BWIs and the developing countries.

Chapter 4 began to look at the innovative mechanisms of the World Bank. All of which were designed to assist the implementation of the FCCC in developing countries. Only GEF has established formal arrangements with the FCCC and built up extensive operational experiences. The restructured GEF has a novel decision-making process that enables more participation from developing countries. It has also established a closer link with the FCCC that gives the authority of making the majority of decisions relating to

GEF operations to the COP to the FCCC, a forum over which developing countries feel they can have more control. All these distinctive characteristics of GEF might help to mitigate the asymmetry problem perceived by the developing countries in the BWIs and, as a result, improve the relationship between the BWIs and the developing countries. On the other hand, this chapter has been able to identify, from the GEF projects and official documents relating to the operations of the GEF, practices similar, but not yet directly comparable, to programme and policy-lending and the application of conditionality, arguably the most powerful legal and quasi-legal instruments employed by the BWIs to influence developing countries.

Thus Chapter 4 implied that with similar practices to conditionality and programme and policy-lending, GEF might have the leverage to produce policy changes in the recipient countries, ie to produce an *outcome*; meanwhile, with the novel governance structure, GEF might help improve the relationship between the World Bank and the developing countries. As a result of this, it might increase the chances of these policy changes being implemented and, ultimately, be able to produce the desirable *impact* in the recipient countries. Thus, GEF might be able to achieve one of its objectives, ie the implementation of the FCCC, more effectively.

What the thesis has pointed out was that, legal and quasi-legal instruments such as the SAPs, conditionality, and programme and policy-based lending are not themselves blamed for straining the relationship between the BWIs and the developing countries. It was the way in which they were designed and the manner in which they were imposed on the developing countries that provoked such controversies over the years, in particular when they were associated with institutions such as the BWIs whose governance structure has long been subject to demand for reform from the developing countries.

When a financial mechanism such as GEF emerged as a significant source of funding exclusive for environmental purposes for developing countries, it is not difficult to imagine that conditionality and programme and policy-based lending were the least features developing countries would like to see. Nevertheless, as this thesis has argued, GEF, with its novel governance structure and closer link with the FCCC, broke away from the traditional international financial institutions as it provides opportunities for developing countries to participate in the design of conditionality and policy advice. Thus, rather than advocating an outright ban on conditionalities and the like, developing countries might want to take advantage of the opportunities and explore possibilities to design conditionality proportionate to their own needs.

This thesis does take note of the coercive nature of these instruments, which is what makes them so effective at producing an *outcome* in the borrowing governments in the first place. The donors and management of the BWIs are surely aware of the coercive nature in their mechanisms and have used them to promote the development model they perceive as ideal in their developing country members. It is definitely arguable that, by associating closely with the World Bank, GEF and any conditionality might have developed are using the same coercive tools to promote the ideal model of “sustainable development” in the developing countries. The argument that GEF and the BWIs can use tools such as conditionality to promote sustainable development in developing countries, however “imperialistic” it might sound, has its validity, provided that the following two conditions are met. First of all, procedural safeguards must be built in to allow developing countries to participate fully and equally in the process. Secondly, appropriate financial and technological assistance must be provided to enable developing countries to grow out of poverty without deteriorating the environment. Furthermore, as

developing countries have become Parties to the FCCC and agreed to respect its objectives, conditionality and policy advice associated with GEF and the “SAP with a climate safety net” are in any case helping developing countries to comply with their obligations under the FCCC.

Nevertheless, it takes time to change the perceptions developing countries have toward these coercive legal and quasi-legal instruments such as conditionality and program and policy-based lending, or even toward the BWIs. This is beyond the ambit of the thesis. Nevertheless, the World Bank, and the BWIs as a group, could take note of what GEF has been able to achieve in terms of overcoming difficulties to reach a governance structure that is regarded as less asymmetric from the viewpoints of the developing countries. It is not the purpose of the thesis to review the governance structure of the BWIs *as such*. The thesis demonstrated that, with governance structure reform, the BWIs might be more effective in employing their financial, legal and political influence in such a way as to produce both a desirable *outcome*, ie policy changes for the purpose of structural adjustment and development, and an *impact*, ie a prosperous economic state in their developing country members.

Legal and quasi-legal instruments such as conditionality and policy-based lending have been examined in the context of the SAPs and the GEF. They have not yet developed in the case of the other two innovative mechanisms of the World Bank, the AIJ programme and the GCI/PCF. These two mechanisms, established exclusively within the World Bank, operate in a different context from the SAPs and the GEF. Both focus on a single issue of assisting the implementation of the FCCC and both are relevant to joint implementation, an implementation technique under the FCCC. The way they influence developing countries is different from that employed by the SAPs and the GEF.

They are market-oriented mechanisms in which private entities are expected to play a more significant role than the governments and the BWIs. Partly because of this reason, and partly because of the limited operational experiences in these two mechanisms, this thesis does not examine these two mechanisms as closely as the SAPs and the GEF. This, however, does not imply that these two mechanisms are less important than the SAPs and the GEF for the BWIs to play their new role. These two mechanisms might be unable to give the BWIs much leverage over developing country governments since they do not operate in the same manner as the SAPs and GEF do. Nevertheless, the thesis has identified issues in the operations and design of these two mechanisms that have implications on the relationship between the World Bank and its developing countries, which is another essential pillar in the present study. This thesis concludes that the closer link these mechanisms are able to develop with the FCCC, the better the prospects of addressing asymmetry problems perceived by developing countries in the operations of the World Bank.

Chapters 3 and 4 examined the issues that are essential for the BWIs to play a more effective role in the developing countries, including the new role of assisting the implementation of the FCCC. Chapter 5 continued the discussion on this new role by analysing the interaction between the BWIs and the FCCC in more detail. As membership and areas of competence began to overlap between the BWIs and the FCCC, this chapter examined the affect of the FCCC and the Kyoto Protocol obligations on the BWIs' exiting operations from the perspectives of three groups: the institutions themselves, developed country members who hold the majority votes in the Boards of Executive Directors and developing countries. From the BWIs' perspective, as members of international community, they should be subject to the "normative reach of those

MEAs that have been adopted precisely to lay down principles and standards of global applicability” (Handl, 1998, p. 661). The recent practices of the World Bank, such as the internal policies and approval of restructured GEF, confirmed the wider responsibility it required as a member of international community. From the perspectives of both developed and developing countries, their treaty obligations under the climate change regime have, to various degrees, affected their positions under the BWIs either as decision makers or borrowers that are subject to loan obligations. Thus, Chapter 5 posited that the BWIs could no longer carry out their regular operations in total disregard of treaty obligations under the FCCC and the Kyoto Protocol. Based on this conclusion, the chapter also proposed several suggestions on designing a SAP with “a climate safety net” and how future directions the Bank’s innovative mechanisms can take in the best interests of both developed and developing countries.

Chapter 6 presented a case study on four developing countries in South-east Asian to test the arguments proposed in the previous chapters. The difficulties in providing empirical data from existing literature to support the rudimentary conclusion from Chapter 3 with regard to the effectiveness of the SAPs was once again encountered in this chapter. The development path pursued by developing countries in South-east Asia and promoted by the BWIs has produced negative environmental impact in general and contributed to the special circumstances of South-east Asia under climate change regime. The chapter pointed out that this traditional model of “economic” development has led South-east Asia to embark on a development path that impeded South-east Asian governments’ abilities to achieve the objectives of the FCCC.

Under the circumstances, the case study on South-east Asia has two implications for the BWIs. One was concerned with the operations of the World Bank and its

innovative mechanisms. The limited domestic resources of South-east Asia, particularly after the recent financial crisis, to implement the FCCC have provided an opportunity to see whether the World Bank can use its innovative mechanisms constructively and play its new role effectively in assisting the implementation of the FCCC in this region. The other implication was for the wider operations of the BWIs. The environmental impact of the development path pursued by South-east Asia under the support of the BWIs demonstrated the inadequacy of the underpinnings of the traditional model of “economic” development perceived as ideal by the donors and management of the BWIs. The environmental impact of the SAPs was touched upon briefly in Chapter 5 before a moderate suggestion was put forward to for a “SAP with a climate safety net”. From the case study on South-east Asia, it was vividly illustrated that a successfully “adjusted” region with impressive “economic” development, with significant influence from the BWIs in the process of adjustment, could contribute to domestic, regional and global environmental problems. Thus, the case study showed that, as long as the BWIs stopped short of re-evaluating the fundamental underpinnings of “development” they perceive as ideal, and the economic theories behind the design of their SAPs, the causes of and solutions to climate change and environmental degradation in general will remain unresolved.

The BWIs have witnessed various socio-economic changes in the environment in which they operate. They have responded to the changing demands of services required by their member states as well. During the past five decades, the BWIs have proved to be flexible with respect to their institutions and operations in meeting these challenges. When the threat of climate change requires fundamental changes in all aspects of

economic activities, the BWIs face a new challenge and is required to play a new role in assisting the implementation of the FCCC in their developing country members.

The present study set out to examine whether the experiences of the BWIs in promoting “economic” development can offer valuable insights on the methods that they can use to promote “sustainable” development through assisting the implementation of the FCCC. By examining the relationship between the BWIs and the developing countries and its implications on the effectiveness of the legal and quasi-legal instruments employed by the BWIs, the thesis has been able to identify lessons to be learned from the existing operations of the BWIs. If properly taken into account and addressed, these lessons might help the BWIs, especially the World Bank to play the new role more effectively.

The issues that have been identified as significant in the present study are yet to be tested empirically and do not represent all the elements that make the operations of the BWIs effective. The suggestions and evaluations proposed in this thesis are neither exhaustive nor comprehensive. Nevertheless, the present study offers a new perspective on addressing the emerging and important issue of interaction between international financial institutions and the MEAs in general, and the relationship between the BWIs and the FCCC more specifically. With the proliferation of the MEAs and increasing global economic and environmental interdependence, the function and perception of international law and international institutions are undergoing rapid transformation and have been subject to extensive discussion among legal scholars. The thesis endeavours to contribute to the growing literature on the subject from the more specific aspect of re-examining the traditional roles and operations of the Bretton Woods Institutions as a more practical way to approach this evolving subject.

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